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IN THE

Supreme Court of the United States

THE CHASE MANHATTAN BANK, as Indenture Trustee, under the Indenture, dated as of May 6, 1998,

Petitioner,

v.

TRAFFIC STREAM (BVI) INFRASTRUCTURE LIMITED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Did the Court of Appeals for the Second Circuit err when it held, contrary to the holdings of the Third, Fourth and Seventh Circuits, that citizens of the British Overseas Territories, such as Bermuda and the British Virgin Islands, were not "citizens or subjects of a foreign state" for the purposes of alienage jurisdiction and thus could not maintain an action in Federal Court under 28 U.S.C. § 1332(a)(2)?

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Supreme Court Rules, Petitioner, The Chase Manhattan Bank ("Chase") states that it is wholly-owned by J.P. Morgan Chase & Co., a publicly-owned company.

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The Memorandum Opinion and Order of the United States District Court for the Southern District of New York in *The Chase Manhattan Bank, as Indenture Trustee, under the Indenture, dated as of May 6, 1998 v. Traffic Stream (BVI) Infrastructure Limited* is reported at 2000 WL 573232 (S.D.N.Y. May 8, 2000) and set forth in the Appendix hereto (App. 8a-14a).

The Opinion and Order of the United States District Court for the Southern District of New York in *The Chase Manhattan Bank, as Indenture Trustee, under the Indenture, dated as of May 6, 1998 v. Traffic Stream (BVI) Infrastructure Limited* is reported at 86 F. Supp. 2d 244 (S.D.N.Y. 2000) and set forth in the Appendix hereto (App. 15a-54a).

BASIS FOR JURISDICTION

The United States Court of Appeals for the Second Circuit reversed the Final Judgment of the District Court for the Southern District of New York on May 24, 2001 (App. 1a-7a). On July 24, 2001, the United States Court of Appeals for the Second Circuit denied Chase's timely filed petition for rehearing *en banc* (App. 55a-56a). This petition for a writ of certiorari is filed within 90 days from the date of the denial of the petition for rehearing *en banc*. 28 U.S.C. § 2101(c); SUP. CT. R. 13.3.

The jurisdiction of this Court is invoked pursuant to the provisions of 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution, Article III, Section 2:

> The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; — to all Cases affecting Ambassadors, other public Ministers and Consuls; — to all Cases of admiralty and maritime Jurisdiction; — to Controversies to which the United States shall be a Party; — to Controversies between two or more States; — between a State and Citizens of another State; — between citizens of different States; — between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

28 U.S.C. § 1332(a):

> The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $75,000, exclusive of interest and costs, and is between —
>
> (1) citizens of different States;

> (2) citizens of a State and citizens or subjects of a foreign state;
>
> (3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and
>
> (4) a foreign state, defined in section 1603(a) of this title, as plaintiff and citizens of a State or of different States.
>
> For the purposes of this section, section 1335, and section 1441, an alien admitted to the United States for permanent residence shall be deemed a citizen of the State in which such alien is domiciled.

STATEMENT OF THE CASE

In May 1998, Traffic Stream (BVI) Infrastructure Limited ("Traffic Stream"), a corporation organized under the laws of the British Virgin Islands, raised $119,000,000 in the United States debt markets by entering into an Indenture, pursuant to which Traffic Stream issued its 14¼% Senior Secured Notes due 2006, to holders of the Notes. The Chase Manhattan Bank ("Chase"), a corporation existing under and by the laws of the State of New York and authorized to exercise trust powers, entered into the Indenture with Traffic Stream and agreed to serve as Trustee. (JA 20-144)[1] The Indenture stated that "[Traffic Stream] irrevocably submits to the jurisdiction of any court of the State of New

---

1. References hereinafter to "JA __" are to pages in the Joint Appendix which was filed in the Second Circuit Court of Appeals.

York or any United States federal court sitting in the Borough of Manhattan, New York City, New York, United States . . . ." (JA 58)

Beginning in January 1999, Traffic Stream committed multiple "Events of Default", as defined in the Indenture, including the failure to pay the semi-annual interest payment due in May 1999. (JA 12-15) Chase commenced this action on June 4, 1999, in the United States District Court for the Southern District of New York, seeking, among other things, a turnover of certain collateral in New York held by Chase, as Trustee, and a deficiency judgment. (JA 18) Traffic Stream, in its amended answer, admitted the Events of Default, but asserted that its performance to pay any amount under the Indenture was excused based on the impossibility defense. (JA 165-75) Chase moved for summary judgment. (JA 196-97)

Summary judgment was granted by the district court in an opinion and order dated January 31, 2000. *Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Ltd.*, 86 F. Supp. 2d 244 (S.D.N.Y. 2000) (Hon. Shira Scheindlin). The district court ordered Chase to foreclose on the collateral, which exceeded $47 million, before submitting its proposed deficiency judgment. *Id.* at 262. The district court issued a second opinion on May 8, 2000, in order to resolve certain disputes about the appropriate deficiency judgment. *Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Ltd.*, No. 99 Civ. 4056 (SAS), 2000 WL 573232 (S.D.N.Y. May 8, 2000).

Traffic Stream appealed to the Second Circuit, raising only the issues regarding the impossibility defense in its brief. At the oral argument before the Second Circuit Panel on December 1, 2000, the Panel raised the issue of whether

subject matter jurisdiction existed under 28 U.S.C. § 1332(a)(2) in light of the fact that the defendant Traffic Stream was incorporated in a United Kingdom Overseas Territory, namely the British Virgin Islands. The Panel referred the parties to three recent cases in which the Second Circuit found that residents and corporations from other United Kingdom Overseas Territories, namely Hong Kong (prior to its transfer to the People's Republic of China) and Bermuda, were not "citizens or subjects of a foreign state" for purposes of alienage jurisdiction.

After the parties submitted supplemental briefing on this issue, the Second Circuit, on May 24, 2001, held that there was no alienage jurisdiction for residents or corporations from the British Virgin Islands because such residents or entities were "stateless" due to the fact that the United States does not regard the British Virgin Islands as an independent, sovereign political entity. The Second Circuit rejected the argument that the residents and individuals from the British Virgin Islands were citizens or subjects of the United Kingdom. The Second Circuit did not address materials that were submitted by Chase, which demonstrated the United Kingdom's and the United States Department of State's position that the residents and corporations from the British Overseas Territories were citizens or subjects of the United Kingdom, and should be recognized as such for purposes of alienage jurisdiction. The Second Circuit also did not address its overruling of its 1996 decision in *Peregrine Myanmar Ltd. v. Segal*, 89 F.3d 41, 45 n.4 (2d Cir. 1996), which had recognized alienage jurisdiction in a case involving a resident of the British Virgin Islands.

On June 7, 2001, Chase filed with the Second Circuit a petition for rehearing *en banc*. This petition was denied on

July 24, 2001. Chase has duly filed its petition for a writ of certiorari within ninety (90) days of the Second Circuit's denial of the motion for rehearing *en banc*.

REASONS FOR GRANTING THE WRIT

THE SECOND CIRCUIT'S DECISION, WHICH IS IN DIRECT CONFLICT WITH EVERY OTHER CIRCUIT THAT HAS ADDRESSED THIS ISSUE, VITIATES THE FOUNDING FATHERS' INTENT THAT ALIENS HAVE ACCESS TO FEDERAL COURTS, SUBJECTS THE UNITED STATES GOVERNMENT TO UNFORESEEN INTERNATIONAL ENTANGLEMENTS AND HAS LED TO SUBSTANTIAL UNCERTAINTIES IN THE COMMERCIAL WORLD OVER THE VALIDITY OF STANDARD CONSENT TO JURISDICTION CLAUSES

In 1997, after two centuries of alienage jurisprudence, a divided panel of the Court of Appeals for the Second Circuit in *Matimak Trading Co. v. Khalily*, 118 F.3d 76 (2d Cir. 1997), *cert. denied*, 522 U.S. 1091 (1998), held that residents and corporations from the British Overseas Territories[2] were "stateless", and, thus, not subject to alienage jurisdiction under 28 U.S.C. § 1332(a)(2). Despite a strong dissent by Judge Altimari in the *Matimak* case and expressions of doubt

2. The British Overseas Territories were formerly referred to as the British Dependent Territories. The British Overseas Territories presently include Anguilla, Bermuda, British Indian Ocean Territory, the British Virgin Islands, the Cayman Islands, the Falkland Islands, Gibraltar, Montserrat, the Pitcairin Islands, Saint Helena and dependencies, South Georgia and the South Sandwich Islands, and the Turks and Caicos Islands.

by other Second Circuit judges,[3] the Second Circuit followed the rule in *Matimak* in *Koehler v. Bank of Bermuda (New York) Ltd.*, 209 F.3d 130 (2d Cir.), *amended by* 229 F.3d 424 (2d Cir.), *reh'g en banc denied by* 229 F.3d 187 (2d Cir. 2000); and *Universal Reinsurance Co., Ltd. v. St. Paul Fire & Marine Insurance Co.*, 224 F.3d 139 (2d Cir. 2000). The culmination of this line of cases is the Second Circuit's unique ruling in this case that residents and corporations from the British Virgin Islands are also "stateless" and not subject to the alienage jurisdiction provisions of 28 U.S.C. § 1332(a). *Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Ltd.*, 251 F.3d 334 (2d Cir. 2001).

The Second Circuit's analysis in *Matimak* began with the principle that the term "foreign state" in 28 U.S.C. § 1332(a)(2) refers only to nations formally recognized by the Executive Branch. *Matimak*, 118 F.3d at 79. Since Hong Kong was a British Territory that was not recognized by the Executive Branch as a "foreign state" unto itself, the Second Circuit concluded that alienage jurisdiction could not be invoked by a "citizen or subject" of Hong Kong.[4] *Id.* at 82-

3. *See, e.g.*, *Koehler v. Bank of Bermuda (N.Y.) Ltd.*, 229 F.3d 187 (2d Cir. 2000) (Judges Sotomayor, Leval and Calabresi dissenting); *Koehler v. Bank of Bermuda (N.Y.) Ltd.*, 229 F.3d 424-25 (2d Cir. 2000) (Judges Cardamone and Newman stating that they "would rule that citizens of Bermuda and other British Dependent Territories are sufficiently subject to the sovereignty of the United Kingdom to satisfy the alienage clause of the diversity statute").

4. The *Matimak* case concerned a citizen of Hong Kong, which in 1996 was a British Overseas Territory. In a case brought in 1999, after Hong Kong became an Administrative Region of the People's Republic of China (the "PRC"), the district court held that a Hong Kong citizen could now sue in federal court as a citizen of the PRC. *Favour Mind Ltd. v. Pacific Shores, Inc.*, No. 98 Civ. 7038(SAS), 1999 WL 1115217 at *6-7 (S.D.N.Y. Dec. 7, 1999).

83. The Second Circuit then analyzed whether a corporation or resident of Hong Kong was a "citizen or subject" of the United Kingdom. After first stating that "[w]e begin with the truism that a foreign state is entitled to define who are its citizens and subjects", the *Matimak* court then tried to determine whether the United Kingdom considered residents and corporations from its territories as citizens. *Id.* at 85. Looking at two British statutes, the *Matimak* court concluded that residents and corporations from the United Kingdom's Overseas Territories were not citizens or subjects of the United Kingdom, and, thus, were stateless. *Id.* at 85-86.

Two years later, the Second Circuit, over strong dissent, extended the *Matimak* rule to residents of Bermuda in the *Koehler* and *Universal Reinsurance* cases. In the *Koehler* case, three judges dissented from the denial of rehearing *en banc* and laid out the reasons why this Court should review this issue. Judge Sotomayor, joined by Judges Leval and Calabresi, criticized the *Matimak* opinion, and wrote that "it can only be hoped the Supreme Court chooses to address the resolution of this issue expeditiously." *Koehler*, 229 F.3d at 194. The dissent, referring to *Matimak* as "flawed and internationally troublesome", pointed out that the United Kingdom and the Executive Branch had asked for reconsideration of the reasoning employed in *Matimak*. *Id.* at 187. As the dissent noted, the *Matimak* court's belief that there would be no sovereign to offend had been proved wrong by the United Kingdom's strong reaction, and, thus, the decision frustrated the fundamental purpose of alienage jurisdiction — avoiding offense to foreign nations. *Id.* at 188. The dissent further noted that "[o]ur Circuit is alone in concluding that federal alienage jurisdiction does not extend to citizens and corporations of British Overseas Territories." *Id.* at 189. It then concluded that the *Matimak* court's

interpretation of the United Kingdom's laws had been based on an erroneous reading of those laws, and that the Overseas Territories and their governments exist under the sovereignty of the Crown and are not "stateless" entities. *Id.* at 192 & n.11.

A. The Ruling in the Second Circuit Has Caused a Split in the Circuits and Destroyed the Uniform Application of Alienage Jurisdiction

The Second Circuit's position that residents and corporations from the British Overseas Territories are "stateless" has been rejected by every other Circuit of the Court of Appeals that has addressed this issue. The Third, Fourth, and Seventh Circuits have uniformly held that residents and corporations from these Overseas Territories are "citizens or subjects" of the United Kingdom for purposes of alienage jurisdiction.

In *Southern Cross Overseas Agencies v. Wah Kwong Shipping Group Ltd.*, 181 F.3d 410, 412-13 (3d Cir. 1999), a New Jersey corporation and a Pennsylvania corporation sued a Hong Kong corporation in federal court.[5] The Third Circuit, deferring to the opinion of the State Department, specifically rejected the Second Circuit's holding in *Matimak* and held that the district court had alienage jurisdiction over the dispute. The Third Circuit stated:

> We accord substantial weight to the State Department's position. . . . [I]t considers Hong Kong corporations to have been subjects of the United Kingdom for alienage diversity purposes. This, it

5. Although Hong Kong became an Administrative Region of the People's Republic of China in July 1997, the court noted that Hong Kong was a British Dependent Territory at the time the complaint was filed. *Southern Cross Overseas Agencies, Inc.*, 181 F.3d at 414 n.2.

> represents, best reflects the actual relationship between the United Kingdom, Hong Kong, and the United States. There is no indication that the United Kingdom disagrees. . . . [W]e agree with the State Department that treating Hong Kong corporations as United Kingdom subjects comports with the facts and the law of alienage jurisdiction.

Id. at 418.

Similarly, in *Wilson v. Humphreys (Cayman) Ltd.*, 916 F.2d 1239, 1242-43 (7th Cir. 1990), *cert. denied*, 499 U.S. 947 (1991), the Seventh Circuit held that alienage jurisdiction existed over a suit brought by residents of Illinois against a Cayman Islands corporation. The Seventh Circuit found "no reason to depart from the weight of authority." *Id.* at 1243. The Court reasoned:

> Certainly, the exercise of American judicial authority over the citizens of a British Dependent Territory implicates this country's relationship with the United Kingdom — precisely the raison d'etre for applying alienage jurisdiction. Not applying alienage jurisdiction in this case would allow "form rather than substance" to govern.

Id. (citation omitted).

Likewise, in *Koehler v. Dodwell*, 152 F.3d 304, 308 (4th Cir. 1998), a suit brought by a Maryland resident against a Bermuda resident for misrepresentation, the Fourth Circuit held that diversity jurisdiction existed because the Bermuda resident was a "citizen or subject" of the United Kingdom.

Given the conflict between the Second Circuit and the decisions of the Third, Fourth and Seventh Circuits on an issue involving federal court subject matter jurisdiction, Petitioner respectfully submits that the Supreme Court should grant the petition for a writ of certiorari in order to ensure uniformity among the federal courts and so ensure the fundamental legal principle that the reach of the federal courts' jurisdiction is the same nationwide. Such uniformity is most important to the capital markets which routinely utilize indentures and other similar documents that include jurisdictional clauses virtually identical to the one in this case.

B. The Second Circuit's Opinion is Contrary to the Founding Fathers' Intent to Ensure Aliens Access to the Federal Courts

The Supreme Court should also review the Second Circuit's decision because it vitiates the very reasons the Founding Fathers included alienage jurisdiction in the Constitution. After the Revolutionary War and prior to the adoption of the Constitution, the state courts, fueled by a mixture of anti-British and anticreditor sentiment, made it difficult for British creditors to collect debts from local debtors. *See* Kevin R. Johnson, *Why Alienage Jurisdiction? Historical Foundations and Modern Justifications For Federal Jurisdiction Over Disputes Involving Noncitizens*, 21 Yale J. Int'l L. 1, 6 (1996). Alienage jurisdiction was seen as a means of addressing this problem by providing foreign litigants with a neutral federal forum. *See id.* The writings of the Founding Fathers indicate that two predominant reasons were advanced as the basis for alienage jurisdiction.

The first of these reasons was to prevent entanglements with foreign governments that became upset when their citizens were unfairly treated by a less-than-neutral state court. Alexander Hamilton set forth this concern in *The Federalist No. 80*:

> [T]he peace of the WHOLE ought not be left at the disposal of a PART. The Union will undoubtedly be answerable to foreign powers for the conduct of its members. And the responsibility for an injury ought ever to be accompanied with the faculty of preventing it. As the denial or perversion of justice by the sentences of courts, as well as in any other manner, is with reason classed among the just causes of war, it will follow that the federal judiciary ought to have cognizance of all causes in which the citizens of other countries are concerned. This is not less essential to the preservation of the public faith than to the security of the public tranquility. A distinction may perhaps be imagined between cases arising upon treaties and the laws of nations and those which may stand merely on the footing of the municipal law. The former kind may be supposed proper for the federal jurisdiction, the latter for that of the States. But it is at least problematical whether an unjust sentence against a foreigner, where the subject of controversy was wholly relative to the *lex loci*, would not, if unredressed, be an aggression upon his sovereign, as well as one which violated the stipulations in a treaty or the general law of nations. And a still greater objection to the distinction would result from the immense difficulty, if not impossibility, of a practical

> discrimination between the cases of one complexion and those of the other. So great a proportion of the cases in which foreigners are parties involve national questions that it is by far most safe and most expedient to refer all those in which they are concerned to the national tribunals.

The Federalist No. 80, at 476-77 (Alexander Hamilton) (Clinton Rossiter ed., 1961). This foreign relations aspect of alienage jurisdiction is set forth not only in *The Federalist*, but also in the writings of many of the other Founding Fathers.

> [T]here is a particular & very cogent reason for securing to foreigners a trial . . . in a federal court. With respect to foreigners, all of the states form but one nation. This nation is responsible for the conduct of all its members towards foreign nations, their citizens & subjects; and therefore ought to possess the power of doing justice to the latter. Without this power, a single state, or one of its citizens, might embroil the whole union in a foreign war.

Letter from Timothy Pickering to Charles Tillinghast (Dec. 24, 1787), in 14 *The Documentary History of the Ratification of the Constitution* 204 (1983).[6]

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6. *See also* 4 *Debates in the Several State Conventions on the Adoption of the Federal Constitution* 158-59 (Jonathan Elliot ed., 1888) (Comments of William Davie of North Carolina); 3 *id.* at 533-34 (Comments of James Madison of Virginia); 2 *id.* at 492-93 (Comments of James Wilson of Pennsylvania).

The second of the major purposes behind alienage jurisdiction was to promote foreign investment in and trade with the fledgling republic. The Founding Fathers recognized that the ill treatment of foreigners by the state courts could discourage foreign investment. James Madison, in particular, noted this aspect of the need for alienage jurisdiction: "We well know, sir, that foreigners cannot get justice done them in [state] courts, and this has prevented many wealthy gentleman from trading or residing among us." 3 Eliot, *supra*, at 583.

As set forth hereafter, the *Matimak* holding that the residents and corporations of the British Overseas Territories are "stateless" and unable to participate in any federal forum under the alienage jurisdiction provisions completely undercuts the express intent of the Founding Fathers to prevent foreign entanglements and to promote trade.

C. The *Matimak* Decision Has Led to a Foreign Entanglement with the United Kingdom

The Second Circuit's opinions have created an entanglement with one of the United States' greatest allies, the United Kingdom. After *Matimak*, the United Kingdom specifically issued a Diplomatic Note that expressed its "concern about a number of judicial decisions which have denied corporations of United Kingdom Overseas Territories access to United States Federal Courts." *See* Diplomatic Note No. 13/2000 from the British Embassy in Washington, D.C. to the United States State Department, Feb. 2, 2000 at 1.[7] The Diplomatic Note further states:

7. The Diplomatic Note was attached as an exhibit to the United Kingdom's amicus curiae brief submitted to the United States Court (Cont'd)

> The United Kingdom also views with great concern the potential application of the Matimak rationale to individual Overseas Territories residents, as well as to commercial enterprises.
>
> The United Kingdom notes that all corporations validly incorporated under the laws of the United States and its territories are entitled to sue and be sued in the courts of the United Kingdom and its Overseas Territories. As a matter of international comity and reciprocity, the United Kingdom considers that United States Federal Courts should be open to corporations established in United Kingdom Overseas Territories.

See id. The United Kingdom has also been vigorous in submitting briefs to various courts that have addressed this issue, asserting that the residents and corporations of its Overseas Territories are its "citizens or subjects".[8] The United

(Cont'd)
of Appeals for the Fifth Circuit in the matter captioned *ART 57 Properties, Inc. v. 57 BB Property, L.L.C.*, No. 99-10385 (5th Cir.) (affirmance reported at 212 F.3d 596 (5th Cir. 2000)). The United States Department of State also submitted an amicus curiae brief in this matter. Both of these briefs, including the attached Diplomatic Note, were appended to Chase's Supplemental Brief that was submitted to the Court of Appeals on December 18, 2000. Hereinafter, the United Kingdom's and the State Department's briefs in the *ART 57 Properties, Inc.* matter will be referred to as the "UK ART 57 Brief" and the "US ART 57 Brief," respectively.

8. Besides its most recent submission to the Fifth Circuit in the *ART 57 Properties, Inc.* case, the United Kingdom has also submitted an amicus curiae brief in support of a petition for a writ of certiorari (Cont'd)

States Department of State has also made multiple submissions to various courts, urging that the residents of the British Overseas Territories be treated as citizens or subjects of the United Kingdom.[9] Such submissions by both the governments of the United Kingdom and the United States indicate that the Second Circuit's conclusion in *Matimak* that declaring the residents of the British Overseas Territories "stateless" would not have any foreign policy repercussions was clearly in error.

D. The *Matimak* Line of Decisions Will Have an Adverse Economic Impact

It is also obvious that rather than promote economic investment in the United States, the Second Circuit's line of decisions adversely affects it. There is no doubt that the *Matimak* line of cases deprives a considerable number of foreign entities and individuals an opportunity to have their claims heard in federal courts within the Second Circuit. Even today, foreign entities and individuals still are leery, as the Founding Fathers pointed out, of possible partiality on the

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(Cont'd)

to the Supreme Court in *Matimak* and an amicus curiae brief in support of the plaintiff's opposition to a motion to dismiss in the matter captioned *III Finance Ltd. v. Aegis Consumer Funding Group, Inc.*, No. 99 Civ. 2579 (DC) (S.D.N.Y.) [decision reported at 1999 WL 1080371 (S.D.N.Y. Nov. 30, 1999)].

9. The United States submitted an amicus curiae brief to the Second Circuit in the *Matimak* matter (*see Matimak*, 118 F.3d at 86 (noting Department of Justice's position)), to the Fifth Circuit in the *ART 57 Properties, Inc.* matter and to the Third Circuit in the *Southern Cross Overseas Agencies, Inc.* matter (*see* 181 F.3d at 417 (noting the State Department's brief)).

part of the state courts. *See* Johnson, *supra*, at 33 ("Many foreign corporations and business associations have fears similar to those of their British predecessors."). The Diplomatic Note from the United Kingdom explicitly notes the adverse economic impact:

> The United Kingdom wishes to make clear its position that corporations incorporated under the laws of any of its Overseas Territories are subjects of the United Kingdom. The United Kingdom is therefore of the view that such corporations ought to be amenable to the alienage jurisdiction of the United States Federal Courts under section 1332 (a) (2) of title 28 of the United States Code, whether as plaintiffs or defendants. Court decisions which fail to recognise such jurisdiction may have a serious detrimental effect on the trading relationship between the United States and the United Kingdom Overseas Territories.

Diplomatic Note, *supra*.

The British Overseas Territories are becoming large economic and financial centers,[10] yet due to the law now

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10. In the UK ART 57 Brief the United Kingdom stated that:

> By recent estimates, there were over 350,000 international business companies incorporated in the British Virgin Islands. There were 563 banks, 377 insurance companies, and 33,792 business companies incorporated in the Cayman Islands. In Bermuda there were 1,400 insurance companies and 6,824 business

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settled in the Second Circuit, such companies may be less willing to do business in the United States. This is especially problematic when one considers that many commercial contracts and financial instruments, like the Indenture in this case, call for a forum in New York, traditionally the financial center of the United States. Petitioner is trustee under numerous sophisticated debt indentures collectively concerning billions of dollars, which contain consent to jurisdiction clauses similar to the one at issue here, signed by aliens as part of major debt offerings issued in this country. The negative impact on these types of financings from a decision which injects substantial uncertainty, and disparity between Circuits, into a previously-settled area of the law as critical as that of subject matter jurisdiction cannot be overstated.

E. *Matimak*'s Novel Interpretation of 1332(a)(2) is Based on an Incorrect Reading of U.K. Law

Matimak and the cases applying it, including this one, were incorrectly decided. At the core of the *Matimak* analysis was "the truism that a foreign state is entitled to define who are its citizens or subjects." *Matimak*, 118 F.3d at 85. In trying to determine if the United Kingdom deemed the residents of its territories as "citizens or subjects" under 1332(a)(2), the Court looked to both the British Nationality Act 1981 and the British Companies Act 1948. *Id.* at 85-86. The *Matimak* court concluded that under the law of the United Kingdom,

(Cont'd)

> companies incorporated. In the Turks and Caicos Islands, 1911 insurance companies and 11,000 business companies were incorporated.

UK ART 57 Brief, at 20.

corporations from the Overseas Territories were not citizens or subjects of the United Kingdom, and thus were "stateless". *Id.* at 86. The United Kingdom strongly disagrees.

The United Kingdom has clearly pointed out in subsequent amicus briefs that it is internationally responsible for the residents and corporations from its overseas territories and that such residents and corporations are subject to United Kingdom sovereignty. As the United Kingdom has explained, while "Great Britain" is the collective term for England and Wales, and Scotland, the "United Kingdom," as a State and subject of international law, includes Northern Ireland, the United Kingdom Overseas Territories and the Crown Dependencies. *See* UK ART 57 Brief, at 5. Like England and Wales, Scotland, and Northern Ireland, each Overseas Territory and Crown Dependency is a separate law district, entitled to enact its own laws in accordance with its constitution. *See* UK ART 57 Brief, at 6. Although each law district has separate laws, they all belong to one state, the United Kingdom, and are subject to United Kingdom sovereignty.

For example, under the United Kingdom Government's Diplomatic Service Procedure Manual, Vol. 7, Annex 1 (Mar. 1996), the term "United Kingdom National" is defined to include "British Dependent Territories Citizens" and "[c]ompanies incorporated under the law of the United Kingdom or of any territory for which the United Kingdom is internationally responsible." *See* UK ART 57 Brief, at Exhibit 2, Rule 1(b).

The fact that the United Kingdom considers the residents and corporations from its territories as its "nationals" should be no surprise when one considers, as an example, the

relationship between the British Virgin Islands and United Kingdom. The Governor of the British Virgin Islands, who is appointed by the Queen, is responsible for core government functions including internal security, public service and court administration. *See* UK ART 57 Brief, at 14. Similarly, any bill passed by the Legislative Council of the British Virgin Islands must be approved by the Governor and the Queen, with such procedure including a careful review by the United Kingdom's Foreign and Commonwealth Office. *Id.* at 14-15. Further, the United Kingdom not only negotiates international treaties on behalf of the British Virgin Islands, but also executes them on behalf of the British Virgin Islands. *See, e.g.*, United Kingdom of Great Britain and Northern Ireland (on Behalf of the British Virgin Islands) and the United States of America: Exchange of Letter Constituting a Narcotics Cooperation Agreement with Respect to the British Virgin Islands, 1681 U.N.T.S. 28491 (April 14, 1987).

The British Virgin Islands has stated that its citizens and corporations are subject to the sovereignty of the United Kingdom. The Attorney General for the British Virgin Islands, Cherno S. Jallow, issued a statement dated February 3, 2000, that fully supports the conclusion that residents and corporations of the British Virgin Islands are subjects of the United Kingdom. *See* UK ART 57 Brief, at Exhibit 3 ("On behalf of the Government of the British Virgin Islands, I fully support the arguments and conclusions presented in the [*ART 57 Properties*] Brief of the United Kingdom."). In this instance, where the three relevant governments (the United Kingdom, the British Virgin Islands and the United States) all have opined that the residents of the British Virgin Islands are subjects of the United Kingdom, there can be no reasoned argument which would allow a court to reach a different conclusion. *See Favour Mind Ltd.*, 1999 WL 1115217 at *6-

7 & n.12 (holding that corporations from post-reversion Hong Kong were subjects of the PRC based on the uniform positions of the PRC, Hong Kong SAR and the United States); *see also Southern Cross Overseas Agencies*, 181 F.3d at 418 ("We accord substantial weight to the State Department's position").

An historical analysis of the development of the alienage jurisdiction provision reveals that there is no basis for the Second Circuit's narrow reading of that provision in *Matimak*. "[T]he drafters of the Constitution chose the words 'citizens' or 'subjects' to refer to the broad category of those under the authority of a foreign power." *Koehler*, 229 F.3d at 191 (Sotomayor, J., dissenting) (citing *Bank of the United States v. Deveaux*, 9 U.S. (5 Cranch) 61, 87, 3 L. Ed. 38 (1809) (Marshall, C.J.)). Section 11 of the Judiciary Act of 1789 provided for jurisdiction in cases in which "an alien is a party, or the suit is between a citizen of the State where the suit is brought, and a citizen of another State." Judiciary Act of 1789, ch. 20, § 11, 1 Stat. 73, 78. Apparently the framers and drafters of this first Judiciary Act used the terms foreigners and aliens interchangeably when referring to non-United States citizens or subjects. *Koehler*, 229 F.3d at 191 (citing *Southern Cross Overseas Agencies, Inc.*, 181 F.3d at 416).

In 1875, the alienage jurisdiction provisions were amended such that the term "alien" was replaced by the current "citizens or subjects" language. This change, however, was not made in order to narrow the meaning of "alien", but rather was intended to have the statute mirror the Constitution in order to make it clear that the federal courts did not have jurisdiction over disputes between aliens. *See* Johnson, *supra*, at 21.

Thus, the understanding of the terms "alien" and "citizens or subjects" as simply an indication that someone is under the sovereignty of another nation should continue today. In fact, prior to 1997 the Second Circuit, itself, had maintained this understanding and had never found that a resident or corporation from a recognized nation's territories was "stateless". The Second Circuit, in *Peregrine Myanmar Ltd. v. Segal*, 89 F.3d 41, 45 n.4 (2d Cir. 1996), actually held that there was jurisdiction in an action between a New York corporation and a British Virgin Islands corporation. The sudden change, just a year later, was not precipitated by a change in the Judiciary Act or the legal status of British Dependent Territory residents by the United Kingdom. Instead, this change was simply a change in interpretation — an interpretation with which all other circuits deciding this issue have disagreed.

F. The Problems Engendered by the *Matimak* Line of Decisions Will Not Be Ended until This Court Resolves This Issue

The significance of this issue continues to grow. Since *Matimak* at least nine cases in the Second Circuit have been dismissed where one of the parties was a resident or entity from the British Overseas Territories.[11] If any of these cases

11. *See, e.g.*, *Koehler*, 209 F.3d at 139 (dismissing action against Bermuda defendants); *Universal Reinsurance Co., Ltd.*, 224 F.3d at 141 (holding there would be no alienage jurisdiction for a domiciliary of Bermuda); *General Star Indem. Co. v. Platinum Indem. Ltd. Bank of Am.*, No. 00 Civ. 4960(LMM), 2001 WL 40763 at *1-2 (S.D.N.Y. Jan 17, 2001) (holding that there was no subject matter jurisdiction because the defendant is a Bermuda corporation.); *New Heaven Properties Ltd. v. Grinberg*, No. 99 Civ. 11546(LMM), 2001 WL (Cont'd)

were commenced in the Third, Fourth or Seventh Circuits, the cases would not have been dismissed because the British Overseas Territories are not viewed as "stateless" jurisdictions in those circuits. In addition, one district court in the Second Circuit has gone so far as to recognize that the argument may be extended to other nations' dependencies.[12] With each dismissal, the Constitutional purpose for alienage jurisdiction is thwarted. The United Kingdom can only become more and more concerned as its citizens and the residents of its Overseas Territories are denied access to federal court, and the Executive Branch can only be more and more embarrassed that the courts in the financial center of the country have taken a position, in direct contrast to the Constitution and the rest of the country, that deems the residents of the territories of one of our greatest allies as

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64842 at *1-3 (S.D.N.Y. Jan. 26, 2000) (dismissing a British Virgin Islands corporation's complaint); *III Fin. Ltd. v. Aegis Consumer Funding Group, Inc.*, No. 99 Civ. 2579(DC), 1999 WL 1080371 at *3-4 (S.D.N.Y. Nov. 30, 1999) (granting defendant's motion to dismiss because the plaintiff was a Cayman Islands corporation); *United States Fid. & Guar. Co. v. Braspetro Oil Servs. Co.*, No. 97 Civ. 6124(JGK), 1999 WL 307666 at *3-4 (S.D.N.Y. May 17, 1999) (dismissing action against a Cayman Islands defendant), *aff'd*, 199 F.3d 94 (2d Cir. 1999); *Lucky Yeh Int'l, Ltd. v. Happiness Express, Inc.*, No. 96 Civ. 3365(SJ), 1999 WL 147095 at *3 (E.D.N.Y. March 12, 1999) (dismissing Hong Kong corporation's complaint); *Klein v. Marriott Int'l., Inc.*, 34 F. Supp. 2d 176, 178-80 (S.D.N.Y. 1999) (dismissing complaint against Bermuda defendant).

12. *See, e.g.*, *Inarco Int'l. Bank N.V. v. Lazard Freres & Co.*, No. 97 Civ. 0378(DAB), 1998 WL 427618 at *1-2 (S.D.N.Y. July 29, 1998) (recognizing that defendant sought to dismiss Aruban bank's complaint because Aruba was a Dutch dependency, but then dismissing complaint on another jurisdictional basis).

"stateless." Absent the Supreme Court's decision to address this issue in this case, there will continue to be a fundamental split between the Second Circuit on one hand, and the Constitution, the Founding Fathers and the other Circuits on the other hand. As stated in Judge Sotomayor's dissent in *Koehler*, 229 F.3d at 193-94, in which the Second Circuit denied a motion for rehearing *en banc*:

> Because these panel decisions have caused a clear split in authority with the other circuit courts, and in light of the potential damage to relations between the United States and the United Kingdom and other nations, it can only be hoped that the Supreme Court chooses to address the resolution of this issue expeditiously.

CONCLUSION

For all the reasons set forth herein, the petition for a writ of certiorari should be granted, the decision of the United States Court of Appeals for the Second Circuit should be reversed, and the matter remanded to the Second Circuit for a decision on the merits of Traffic Stream's appeal.

Dated: October 18, 2001

Respectfully submitted,

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APPENDIX

APPENDIX A — PER CURIAM OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED AND DECIDED MAY 24, 2001

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2001

(Originally submitted: December 1, 2000
Final submission: December 18, 2000
Decided: May 24, 2001)

Docket No. 00-7721

THE CHASE MANHATTAN BANK, as Indenture Trustee, under the Indenture, dated as of May 6, 1998,

Plaintiff-Appellee,

v.

TRAFFIC STREAM (BVI) INFRASTRUCTURE LIMITED,

Defendant-Appellant.

Before: McLAUGHLIN and SACK, *Circuit Judges*, and CHATIGNY, *District Judge*.*

* * *

* The Honorable Robert N. Chatigny, of the United States District Court for the District of Connecticut, sitting by designation.

Appendix A

PER CURIAM:

BACKGROUND

Traffic Stream (BVI) Infrastructure Limited ("Traffic Stream"), incorporated in the British Virgin Islands, is the parent of four wholly owned Hong Kong subsidiaries. Through these subsidiaries, Traffic Stream owns interests in thirteen Chinese-foreign cooperative joint ventures. Each joint venture is a partnership between one of the Hong Kong subsidiaries and a Chinese partner. The joint ventures are all engaged in the development, construction, and operation of six toll-road projects in China.

The contracts governing the joint ventures guarantee the Hong Kong subsidiaries a fixed annual return on their investments in the toll-road projects. If the operating income generated by a joint venture is less than the fixed annual rate of return, the Chinese partner is obligated to pay the difference to the Hong Kong subsidiary from its own funds. According to Traffic Stream, its income derives "solely and ultimately" from the joint ventures.

In order to finance these joint ventures, Traffic Stream entered into an Indenture with The Chase Manhattan Bank ("Chase"), a New York Corporation, on May 6, 1998. Pursuant to the Indenture, Traffic Stream issued 14 1/4 percent Notes in an aggregate amount of $199,000,000 which are due in 2006. The Indenture requires Traffic Stream to make semi-annual interest payments on the Notes in May and November of each year, commencing in November 1998. Additionally, Traffic Stream executed a Letter of Credit

Appendix A

Procurement and Deposit Agreement according to which it promised to deliver a letter of credit in the amount of $8,058,750 to Chase by January 6, 1999, and to replace the letter of credit by depositing $8,058,750 into a Construction Funding Account on or before May 6, 1999.

The Indenture provided that it was to "be governed by and construed in accordance with" New York law. Traffic Stream agreed by its terms to submit "to the jurisdiction of any court of the State of New York or any United States federal court sitting in the Borough of Manhattan, New York City, New York, United States, and any appellate court from any thereof."

Traffic Stream made its first required interest payment on November 1, 1998. It is undisputed that Traffic Stream thereafter committed multiple defaults.

In response to these defaults, on June 4, 1999, Chase began this action in the United States District Court for the Southern District of New York on the basis of "alienage jurisdiction" grounded on the status of the plaintiff as a New York corporation and the defendant as a British Virgin Islands corporation. *See* § 1332(a). The complaint set forth five claims, all under New York law: (1) breach of contract; (2) replevin of collateral; (3) specific enforcement of defendant's reporting obligations; (4) an accounting; and (5) recovery of costs for collection.

Traffic Stream concedes that, at least technically, it has committed defaults under the Indenture. It asserts, however, that these defaults, which underlie the breach of contract and

replevin claims, are excused by the legal defense of impossibility. Ch e responds, *inter alia*, that the impossibility defense is for various reasons unavailable to Traffic Stream.

On January 31, 2000, the district court (Shira A. Scheindlin, *Judge*) granted Chase's motion for summary judgment. *See Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Ltd.*, 86 F. Supp. 2d 244 (S.D.N.Y. 2000). The court concluded that § 501 of the Indenture barred Traffic Stream's impossibility defense. *Id.* at 256-59. It further held that even if § 501 did not bar the defense, Traffic Stream did not meet the "objectively impossible" element of that defense and that New York does not recognize a defense based on financial impossibility. *Id.* at 259-61. A deficiency judgment in favor of Chase in the amount of $98,388,352.74 was therefore entered on May 9, 2000.

Traffic Stream appeals.

DISCUSSION

"It is axiomatic that federal courts are courts of limited jurisdiction and may not decide cases over which they lack subject matter jurisdiction." *Lyndonville Sav. Bank & Trust Co. v. Lussier*, 211 F.3d 697, 700 (2d Cir. 2000). "[F]ailure of subject matter jurisdiction is not waivable and may be raised at any time by a party or by the court *sua sponte*. If subject matter jurisdiction is lacking, the action must be dismissed." *Id.* at 700-01 (citing *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 541 (1986); *United Food & Commercial Workers Union, Local 919 v. CenterMark Props. Meriden Square, Inc.*, 30 F.3d 298, 301 (2d Cir. 1994)).

Chase's claims against Traffic Stream arise under state law. The federal courts have subject matter jurisdiction over such claims if, *inter alia*, the parties are "(1) citizens of different States; (2) citizens of a State and citizens or subjects of a foreign state; [or] (3) citizens of different States and in which citizens or subjects of a foreign state are additional parties." 28 U.S.C. § 1332(a). The district court in the case at bar proceeded under § 1332(a)(2) on the apparent, unchallenged assumption that Traffic Stream is a "citizen[ ] or subject[ ] of a foreign state" — the United Kingdom or the British Virgin Islands.

In *Matimak Trading Co. v. Khalily*, 118 F.3d 76 (2d Cir. 1997), *cert. denied*, 522 U.S. 1091 (1998), we held that a plaintiff corporation organized under the laws of Hong Kong did not qualify as a "citizen[ ] or subject[ ] of a foreign state" under § 1332(a)(2). At the time of the suit, Hong Kong was a British Dependent Territory. We concluded that "the United States does not regard Hong Kong as an independent, sovereign political entity," and the plaintiff was therefore not a "citizen[ ] or subject[ ] of a foreign state" by virtue of its incorporation in Hong Kong. *Id.* at 82. Under British law, we further held, the plaintiff was not a citizen or subject of the United Kingdom. *Id.* at 85, 86. We therefore decided that the plaintiff Hong Kong corporation was technically "stateless" and that "a stateless person — the proverbial man without a country — cannot sue a United States citizen under alienage jurisdiction." *Id.* at 86.

Similarly, in *Koehler v. Bank of Bermuda (New York) Ltd.*, 209 F.3d 130, *rehearing in banc denied*, 229 F.3d 187 (2d Cir. 2000), the defendants were Bermuda corporations

and an individual with Bermuda citizenship. Bermuda at the time of suit, like Hong Kong at the time of *Matimak*, was a British Dependent Territory. We therefore concluded that "*Matimak* governs the jurisdictional issue in this case" and that "[t]he district court therefore lacked subject matter jurisdiction over the state law claims against the Bermuda defendants." *Id.* at 139. *See also Universal Reinsurance Co. v. St. Paul Fire and Marine Ins. Co.*, 224 F.3d 139, 140-41 (2d Cir. 2000) (Bermuda corporation could not bring suit in federal court on the basis of alienage jurisdiction) (citing *Koehler* and *Matimak*).

Because Traffic Stream is a British Virgin Islands corporation and the parties had not briefed the issue of alienage jurisdiction on appeal, we requested at oral argument that the parties submit supplemental briefs addressing whether the district court had subject matter jurisdiction over this case in light of the *Matimak* line of cases. Each party submitted such a brief.

The British Virgin Islands is a British Dependent Territory, as Hong Kong was at the time of *Matimak* and Bermuda was at the time of *Koehler* and *Universal Reinsurance*. (It is, to be precise, a United Kingdom or British "Overseas Territory," but that is simply a new name for "British Dependent Territory."[1]) Nothing relevant to the

1. In February 1998, the United Kingdom Government announced that all "Dependent Territories" would in the future be known as "Overseas Territories." There is no practical difference between the term "Overseas Territory" used here in reference to the British Virgin

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alienage jurisdiction inquiry has changed since we decided those appeals.[2] We are bound to hold that Traffic Stream is not a citizen or subject of a foreign state and that the district court therefore had no alienage jurisdiction over this action under § 1332(a)(2). No other basis for jurisdiction has been asserted by either party. Federal jurisdiction being absent, the action must be dismissed.

CONCLUSION

Traffic Stream is not a "citizen[ ] or subject[ ] of a foreign state" under 28 U.S.C. § 1332(a)(2), and there is no other basis for federal jurisdiction over this lawsuit. Accordingly, we reverse the judgment of the district court and remand with instructions for the district court to dismiss the complaint without prejudice.

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Islands and the term "Dependent Territory." Nor is there any practical difference between these terms and the terms "dependency," "colony," or "crown colony."

Brief *amicus curiae* for the United Kingdom, 1 n.2, *ART 57 Prop., Inc. v. 57 BB Prop., L.L.C., et al.* No. 99-10385 (5th Cir. 2000) (reported at 212 F.3d 596 (table)).

2. The source material supplied to us by Chase in support of its supplemental brief on the issue of alienage jurisdiction was apparently available to and considered by Judge Sotomayor in writing the opinion in dissent from denial of rehearing in banc in *Koehler*. *See Koehler*, 229 F.3d 187, 188 n.3 (2d Cir. 2000) (Sotomayor, J., with whom Leval and Calabresi, JJ., joined, dissenting from denial of rehearing in banc).

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED MAY 8, 2000

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

99 Civ. 4056 (SAS)

THE CHASE MANHATTAN BANK, AS INDENTURE TRUSTEE, UNDER THE INDENTURE, DATED AS OF MAY 6, 1998,

Plaintiff,

– against –

TRAFFIC STREAM (BVI) INFRASTRUCTURE LIMITED,

Defendant.

MEMORANDUM OPINION AND ORDER

SHIRA A. SCHEINDLIN, U.S.D.J.:

In an Opinion and Order dated February 2, 2000, I granted summary judgment in plaintiff's favor and ordered plaintiff to foreclose on certain Collateral Accounts and to submit a request for a deficiency judgment. *See The Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Limited*, 86 F. Supp. 2d 244, 248, 266 (S.D.N.Y. 2000).[1]

1. Familiarity with the underlying facts resulting in the judgment is assumed.

Plaintiff has done so by submitting an Affidavit of Francis J. Grippo, Vice President of The Chase Manhattan Bank, in Support of Request for Deficiency Judgment, dated February 18, 2000 ("Grippo Aff."). Defendant does not dispute the re-calculated principal amount owed as of March 24, 1999 ($126,040,006.94), *id.* ¶ 2, or the total amount foreclosed on the Collateral Accounts ($49,054,290.84), *id.* ¶ 4. Defendant does dispute plaintiff's calculation of interest from March 24, 1999 through the present and the treatment of other collateral consisting of shares of four of defendant's wholly-owned Hong Kong subsidiaries. *See* Defendant's Objection to Request for Deficiency Judgment ("Obj.") ¶¶ 14-16 and Exhibit C (letter from Thomas Foley, Vice President of The Chase Manhattan Bank, to defendant, dated July 15, 1999, regarding Mortgage of Shares).

In his Affidavit, Mr. Grippo explains that the total debt under the Indenture Agreement was accelerated on March 24, 1999, at which point the new principal amount became $126,040,006.94, consisting of $119,000,000 in original principal and $7,040,006.94 in accrued interest. Grippo Aff. ¶ 2. The $7,040,006.94 accrued interest was calculated as follows. *First*, interest for the period November 1, 1998 through January 2, 1999 was calculated at 14.75% which represents the 14.25% stated interest rate plus 0.50% in additional Special Interest resulting from defendant's failure to have its Registration Statement declared effective on or prior to the 150th day following the date of the Indenture. *Id.* ¶ 2 n.1; *see also* Indenture, attached as Exhibit A to the Grippo Aff., at A-5. *Second*, interest for the period January 2, 1999 through March 24, 1999, the date of acceleration, was calculated at 15.00%, representing the 14.75% interest

rate previously used plus 0.25% in additional Special Interest resulting from defendant's continued failure to have its Registration Statement declared effective.[2] Grippo Aff. ¶ 2 n.2; *see also* Indenture at A-5. This second rate was used through April 2, 1999, corresponding to the end of the first ninety-day period. Then, for the period April 2, 1999 through December 30, 1999, 15.25% was used, representing an additional 0.25% increase for defendant's failure to have its Registration Statement declared effective during the second ninety-day period.[3] Grippo Aff. ¶ 2 n.3; *see also* Indenture at A-5. Finally, from December 31, 1999 through February 19, 2000, a rate of 17.25% was used, consisting of the 15.25% rate previously calculated plus an additional 2% in Penalty Interest resulting from defendant's failure to maintain a Debt Service Coverage Ratio of 1.75 to 1. Grippo Aff. ¶ 2 n.4; *see* also Indenture at A-6.

Defendant objects to the use of the 15.25% and 17.25% rates on the ground that as of the default and acceleration date, March 24, 1999, defendant was no longer required to maintain an effective Registration Statement or the stated Debt Service Coverage Ratio. *See* Obj. ¶¶ 7-8. Defendant contends that interest should continue to accrue at 15.00% because, here, the non-breaching party elected to treat the

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2. Additional Special Interest at a rate of 0.25% accrues for each consecutive ninety-day period that defendant continues to fail to have its Registration Statement declared effective, not to exceed a total of 1.00%. *See* Indenture at A-5.

3. This 15.25% rate was used beyond the second ninety-day period because the aggregate 1.00% limit on Special Interest had been reached (0.50% + 0.25% + 0.25%). *See* Indenture at A-5.

contract as terminated and sue for damages. *See id.* ¶ 10. According to defendant, the 1% step-up for failure to maintain an effective Registration Statement and the 2% penalty for failure to meet the Debt Service Coverage Ratio was

> designed to compensate the bondholder for their (i) inability to freely sell the bonds in the public markets, in the case of the failure to maintain an effective registration statement, and (ii) increased exposure over time due to the decline in the defendant's financial condition, in the case of the failure to meet the Debt Service Coverage Ratio. But here, as of March 24, 1999 the bondholder's inability to sell the bonds in the public markets was due to the default and acceleration, not the failure to maintain an effective registration statement, and their exposure was fixed no later than March 24, 1999. On that date the defendant became liable for all unpaid principle [sic] and interest at the then applicable interest rate.

Obj. ¶ 11.

Plaintiff supports its use of the higher interest rates by citing to two sections of the Indenture Agreement. *First*, plaintiff cites Section 510 which states, in relevant part, that

> no right or remedy herein conferred upon or reserved to the Trustee or to the Holders is intended to be exclusive of any other right or remedy, and every right and remedy shall, to the

> extent permitted by law, be cumulative and in addition to every other right or remedy given hereunder . . . .

Indenture at 53. *See* Plaintiff's Response to Defendant's Objection to Plaintiff's Request for Deficiency Judgment ("Resp.") ¶ 4. Unlike plaintiff, however, I interpret the rights or remedies "herein conferred" to mean those conferred by Article Five of the Indenture Agreement which is entitled "REMEDIES." I do not construe Section 510 to cover the various interest rate triggers described on pages A-5 and A-6 of the Indenture Agreement. Accordingly, Section 510 does not support plaintiff's use of the increased rates.

Second, plaintiff cites Section 309 of the Indenture Agreement. Resp. ¶ 5. Section 309 provides that Defaulted Interest includes "Additional Interest" which is defined in Section 101 as including Special Interest and/or Penalty Interest. *See* Indenture at 41, 2. This citation fails to support plaintiff's argument for the higher interest calculation given that the 15.00% rate does, in fact, include 0.75% in Special Interest.

In short, defendant's obligation to plaintiff became fixed on March 24, 1999, the date of acceleration, as did the rate of interest to be applied to any unpaid amounts. As of that date, the Indenture Agreement, in effect, no longer governed the obligations of the parties except for the payment of amounts then owing. Accordingly, the interest rate increases triggered by defendant's failure to comply with certain provisions of the Indenture Agreement were no longer applicable.

In light of the above, the amount of interest, using a 15.00% interest rate, for the period March 24, 1999 through March 24, 2000 is $18,906,001.41 ($126,040,006.94 * .15 * 1). The accrued interest for the period March 24, 2000 through May 9, 2000 is $2,382,674.10 ($126,040,006.94 * .15 * 46/365). The total amount of accrued interest from March 24, 1999 to the day of judgment is $21,288,675.51.

Thus far, the deficiency judgment shall include $126,040,006.94 in outstanding principal and $21,288,675.51 in accrued interest. To this amount is added $103,590.06 in attorneys' fees and $10,371.07 in disbursements.[4] Defendant did not object to these amounts which appear fair and reasonable. This results in a total amount due of $147,442,643.58. An offset against this amount for the foreclosed Collateral Accounts in the amount of $49,054,290.84 results in a net deficiency judgment of $98,388,352.74.

Against this amount, defendant seeks an offset for the value of certain additional collateral, namely pledged shares of four Hong Kong companies owned by defendant and/or its shareholders. Plaintiff states, however, that the Trustee never obtained control of these companies, nor has there been any valuation of the companies. *See* Resp. ¶ 7. Until these two conditions have been satisfied, specifically transfer of ownership and an adequate, independent valuation, the value of these companies will not affect the amount of the deficiency judgment entered herein. If and when these

4. *See* Affidavit of Sarah L. Reid, plaintiff's attorney, in Support of Request for Attorneys [sic] Fees, dated February 18, 2000 ¶ 2 and Exhibits A (attorney time entries) and B (disbursements posted).

Appendix B

conditions are satisfied, the value of the additional collateral will be applied against the deficiency judgment.

The Judgment Clerk is hereby ordered to prepare a deficiency judgment in accordance with this Opinion.

SO ORDERED:

s/ Shira A. Scheindlin
Shira A. Scheindlin
U.S.D.J.

Dated: New York, New York
May 8, 2000

APPENDIX C — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED JANUARY 31, 2000

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

99 Civ. 4056 (SAS)

THE CHASE MANHATTAN BANK, AS INDENTURE TRUSTEE, UNDER THE INDENTURE, DATED AS OF MAY 6, 1998,

Plaintiff,

– against –

TRAFFIC STREAM (BVI) INFRASTRUCTURE LIMITED,

Defendant.

OPINION AND ORDER

SHIRA A. SCHEINDLIN, U.S.D.J.:

This is a diversity contract action arising out of a high-yield debt instrument. On May 6, 1998, plaintiff Chase Manhattan Bank ("Chase"), acting as Trustee, and defendant Traffic Stream (BVI) Infrastructure Limited ("Traffic Stream") entered into an Indenture Agreement (the "Indenture") pursuant to which defendant issued 14 1/4 percent Senior Secured Notes (the "Notes") in an aggregate

amount of $119,000,000 to various holders. Traffic Stream issued the Notes to finance a business venture involving the construction of toll roads in the People's Republic of China ("China").

On June 4, 1999, plaintiff commenced this litigation contending that Traffic Stream defaulted on its obligations under the Indenture. Plaintiff seeks, among other things, immediate repayment of defendant's indebtedness including both principal and interest. Plaintiff now moves for summary judgment pursuant to Federal Rule of Civil Procedure 56.

In its opposition to plaintiff's motion, defendant admits that it defaulted on its obligations under the Indenture. However, defendant argues that its defaults should be excused pursuant to the contract doctrine of "impossibility of performance." Specifically, defendant contends that a change in Chinese policy delayed defendant's recoupment of monies from the toll-road projects, making it "impossible" for defendant to fulfill its payment obligations under the Indenture.

There is no dispute that defendant defaulted on its obligations under the Indenture. Accordingly, the sole issue with respect to summary judgment is whether defendant can, as a matter of law, plausibly maintain an impossibility defense. Because I find that defendant cannot maintain such a defense, and for the reasons set forth below, plaintiff's motion is granted in its entirety.

I. Jurisdiction

The Court has diversity jurisdiction over this dispute pursuant to 28 U.S.C. § 1332 because plaintiff is a corporate citizen of New York, defendant is a corporate citizen of the British Virgin Islands and the matter in controversy exceeds $75,000. Complaint ¶¶ 1-3; Amended Answer ¶¶ 1,3. Moreover, pursuant to section 112 of the Indenture, Traffic Stream explicitly consents to the personal jurisdiction of this Court over "any, suit, action or proceeding . . . brought in connection with th[e] Indenture or the Notes." Indenture, Ex. A to 10/6/99 Affidavit of plaintiff's counsel Sarah Reid ("Reid Aff."), § 112(a).[1]

II. Background

The following facts are taken from the parties' Rule 56.1 statements and supporting affidavits. Unless otherwise indicated, the facts are undisputed.

A. Traffic Stream

Traffic Stream is a corporation organized under the laws of the British Virgin Islands. Plaintiff's Rule 56.1 Statement of Undisputed Facts ("Pl. 56.1") ¶ 2. Traffic Stream is the parent of four wholly-owned subsidiaries. *Id.* ¶ 4. All four subsidiaries are incorporated in Hong Kong (collectively, the "Hong Kong Subsidiaries"). *Id.* According to defendant,

1. The Indenture also includes a choice of law provision which states: "This Indenture and the Notes shall be governed by and construed in accordance with the laws of the State of New York." Indenture, Ex. A to Reid Aff., § 111. Accordingly, New York law governs the instant dispute.

the Hong Kong Subsidiaries are its sole assets and its sole source of income. Defendant's Rule 56.1 Statement of Undisputed Facts ("Def. 56.1") ¶ 45.[2]

Through its Hong Kong Subsidiaries, Traffic Stream owns interests in thirteen Chinese-foreign cooperative joint ventures (the "Joint Ventures"). Pl. 56.1 ¶ 3. Each Joint Venture is comprised of a foreign partner — one of the Hong Kong Subsidiaries — and a Chinese partner. Def. 56.1 ¶ 48. The Joint Ventures are engaged in the development, construction and operation of six toll-road projects in China. Pl. 56.1 ¶ 3; Def. 56.1 ¶ 44.

B. The Indenture

In order to finance the Chinese toll-road projects, Traffic Stream entered into the Indenture with Chase. 11/1/99 Declaration of Wong Kwok Choi, Executive Director of Traffic Stream, ("Wong Decl.") ¶ 4. As set forth above, pursuant to the Indenture, Traffic Stream issued 14 1/4 percent Notes in an aggregate amount of $119,000,000. Pl. 56.1 ¶ 5. The Notes are due in 2006. *Id.*

Under the terms of the Indenture, Traffic Stream is required to make semi-annual interest payments on the Notes. *Id.* ¶ 7. The payments are due in May and November of each year, commencing in November 1998. *Id.*

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2. Plaintiff does not concede that the Hong Kong Subsidiaries are defendant's sole assets and sole source of income. *See* Plaintiff's Reply Memorandum of Law in Further Support of its Motion for Summary Judgment ("Pl. Reply") at 2. However, plaintiff accepts defendant's assertion as true for purposes of this summary judgment motion. *Id.*

As collateral for Traffic Stream's payment obligations, the Indenture grants Chase first priority security interests in four accounts maintained by defendant: (i) the Debt Service Reserve Account; (ii) the Construction Funding Account; (iii) the Joint Venture Distribution Account; and (iv) the Note Redemption Account (collectively, the "Collateral Accounts"). *Id.* ¶¶ 7-9. In addition, Traffic Stream executed a Letter of Credit Procurement and Deposit Agreement ("LOC and Deposit Agreement") pursuant to which Traffic Stream promised to deliver a letter of credit in the amount of $8,058,750 to Chase by January 6, 1999.[3] *Id.* ¶ 14; LOC and Deposit Agreement, Ex. B to Reid Aff., ¶ 1. Traffic Stream further promised to replace the letter of credit with cash currency on or before May 6, 1999, by depositing $8,058,750 into the Construction Funding Account. Pl. 56.1 ¶ 15.

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3. Technically, Traffic Stream did not itself undertake to procure the required letter of credit. Rather, four additional parties to the LOC and Deposit Agreement — three corporate entities and one individual — agreed to procure and deliver the letter of credit to Chase. LOC and Deposit Agreement, Ex. B to Reid Aff., ¶ 1. The precise nature of the relationship between defendant and the four entities directly responsible for procurement of the letter of credit is unclear from both the face of the LOC and Deposit Agreement and the parties' submissions. However, there is no question that the entities are closely tied to both defendant and the toll-road projects. *Id.* at preamble. Moreover, as discussed *infra*, the failure to deliver the $8,058,750 letter of credit constitutes a default under the Indenture to which only Traffic Stream and Chase are parties. Accordingly, to avoid confusion and for the sake of simplicity, I refer to all obligations under the LOC and Deposit Agreement as "Traffic Stream's" obligations.

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Section 501 of the Indenture explicitly states that any failure by defendant to make timely interest payments or to procure the required letter of credit constitutes an "Event of Default". Section 501 provides, in relevant part, as follows:

> "Event of Default", wherever used herein, means any one of the following events (whatever the reason for such Event of Default and whether it shall be voluntary or involuntary or be effected by operation of law or pursuant to any judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body):
>
> (1) default in the payment of any interest, including Additional Interest, if any, and Additional Amounts, if any, in respect of interest on any Note when it becomes due and payable and continuance of such default for a period of five Business Days; or
>
> . . . .
>
> (4) the failure to deliver to the Trustee the [letter of credit] on or before January 6, 1999 as provided in the LOC and Deposit Agreement (unless the [cash] Deposit shall have been made on or before January 6, 1999) . . . .

Indenture, Ex. A to Reid Aff., § 501(1),(4). The failure to pay "the principal of or premium, if any, on any Note when it becomes due and payable at its Stated Maturity, or the

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failure to redeem Notes in the required principal amounts on any Mandatory Redemption Date" is also an Event of Default under section 501. *Id.* § 501(2).

Pursuant to section 502 of the Indenture, if an Event of Default occurs, Chase, as Trustee, or the Note holders may "declare the principal of, premium, if any, and accrued interest on all of the Outstanding Notes immediately due and payable, and upon any such declaration all such amounts payable in respect of the Notes shall become immediately due and payable." *Id.* § 502.[4] The Indenture further provides that if defendant defaults upon the payment of interest, principal or premium, the defendant must, upon demand by plaintiff, pay the whole amount due plus "such further amount as shall be sufficient to cover the costs and expenses of collection, including the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel." *Id.* § 503.

Finally, section 1009 of the Indenture requires defendant to provide the Trustee with a variety of financial statements and reports. *Id.* § 1009.

C. Traffic Stream's Defaults Under the Indenture

Traffic Stream timely tendered the first required interest payment on November 1, 1998. Pl. 56.1 ¶ 22. Since that time, however, Traffic Stream has committed multiple defaults under the Indenture.

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4. Specifically, the Indenture allows "the Trustee or Holders of not less than 25% in aggregate principal amount of the Notes Outstanding" to accelerate payment. Indenture, Ex. A to Reid Aff., § 502.

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1. Failure to Deliver Letter of Credit

Traffic Stream failed to deliver the required $8,058,750 letter of credit to Chase by January 6, 1999. *Id.* ¶ 24. Such failure constitutes an Event of Default under section 501(4) of the Indenture. *Id.*; Def. 56.1 ¶ 24; Indenture, Ex. A to Reid Aff., § 501(4).[5]

2. Failure to Pay Accelerated Principal

On March 24, 1999, holders of more than 25 percent of the Notes delivered to defendant a Declaration of Acceleration (the "Declaration") pursuant to section 502 of the Indenture. Pl. 56.1 ¶ 26. As a result of the Declaration, the Notes became immediately due and payable. The Declaration also demanded, pursuant to section 503, "the immediate payment in full" of the Notes. *Id.* ¶ 27. Despite the acceleration of the Notes and the demand for immediate

5. Defendant did deliver a letter of credit in the amount of $4,460,000 to Chase on January 11, 1999. Pl. 56.1 ¶ 25. And, on February 12, 1999, defendant delivered to Chase a second letter of credit in the amount of $1,100,000. *Id.* Not only were these letters of credit untimely, they were also insufficient; combined, the letters were in an amount $2,498,750 less than the amount required under the LOC and Deposit Agreement. *Id.*

Traffic Stream also failed to deposit $8,058,750 cash in the Construction Funding Account by May 6, 1999, as required under the LOC and Deposit Agreement. As a result, plaintiff drew the entire amount available under defendant's January 11 and February 12 letters of credit. Pl. 56.1 ¶ 30. However, because defendant failed to procure letters of credit in the required amount, a balance of $2,498,750 remains unpaid and owing to plaintiff under the LOC and Deposit Agreement. *Id.*

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payment, defendant has failed to pay any amounts on the Notes. *Id.* ¶ 27; Def. 56.1 ¶ 27. Such failure constitutes an Event of Default under section 501(2) of the Indenture. Pl. 56.1 ¶ 28; Def. 56.1 ¶ 28; Indenture, Ex. A to Reid Aff., ¶ 501(2).

3. Failure to Pay Interest and Provide Reports

Not only did Traffic Stream fail to honor the holders' demand for "immediate payment in full", it also failed to tender the May 1999 interest payment, which was required even in the absence of the acceleration and demand for payment. Pl. 56.1 ¶ 30. Defendant's failure to make the scheduled interest payment constitutes an Event of Default under section 501(1) of the Indenture. *Id.;* Def. 56.1 ¶ 28; Indenture, Ex. A to Reid Aff., § 501(1).[6]

Finally, Traffic Stream failed to provide certain financial statements and reports to the Trustee as required under section 1009 of the Indenture. Pl. 56.1 ¶ 32.

D. Procedural History

In response to defendant's defaults, Chase commenced the instant action on June 4, 1999.[7] The complaint sets forth

6. It appears that Traffic Stream similarly failed to pay the third installment of accrued interest which came due on November 1, 1999, during the briefing of the instant motion. *See* 11/17/99 Affidavit of Francis J. Grippo, a vice president of Chase, ("Grippo Aff.") ¶ 8; Wong Decl. ¶ 23.

7. Chase brought suit pursuant to section 503 of the Indenture which authorizes the Trustee to institute a judicial proceeding, in its own name, for the collection of sums due, specific performance of the Indenture or any other appropriate remedy. Indenture, Ex. A to Reid Aff., § 503.

five claims: (i) breach of contract; (ii) replevin of collateral; (iii) specific enforcement of defendant's reporting obligations; (iv) an accounting; and (v) recovery of costs for collection. Complaint ¶¶ 32-52. With respect to claims one and two, Chase seeks turnover of the Collateral Accounts as well as damages in the form of a deficiency judgment equal to the difference in value between the Collateral Accounts and the total amount of defendant's indebtedness.[8] *Id.* ¶ 52.

Traffic Stream concedes that it is in default under the Indenture as a result of its failure to post the required letter of credit and its failure to make the required payments. Def. 56.1 ¶¶ 24, 27-28. However, Traffic Stream asserts the legal defense of impossibility with respect to claims one and two — breach of contract and replevin of collateral. *Id.* ¶ 37. Traffic Stream does not assert any legal defenses in connection with Chase's claims for specific performance, an accounting or collection costs. *Id.*

E. Chinese Law and The SAFE Notice

Defendant's impossibility defense to Chase's claims for breach of contract and replevin of collateral is based on an alleged change in Chinese policy regarding remittance of guaranteed funds to foreign investors. According to defendant, the alleged policy change occurred in September 1998.[9]

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8. According to plaintiff, as of October 31, 1999, defendant's total indebtedness under the Indenture was $137,352,444, including $119,000,000 in principal and $11,312,437 in accrued, unpaid interest. Grippo Aff. ¶ 8. Interest continues to accrue on the Notes at a rate of $55,142 per day. *Id.*

9. Plaintiff does not concede the occurrence of a change in (Cont'd)

1. The Joint Ventures

The contracts governing the Joint Ventures guarantee the Hong Kong Subsidiaries, as foreign partners, a fixed annual return on their investments in the toll-road projects. Def. 56.1 ¶ 47; Wong Decl. ¶ 3. If the income generated by a Joint Venture (the "Operating Income") is less than the fixed annual rate of return, the Chinese partner is obligated to pay the difference to the foreign partner from its own funds (the "Guaranteed Income"). Def. 56.1 ¶ 48; Wong Decl. ¶ 3. According to defendant, the fixed annual rate of return is sufficient to cover all interest payments due under the Indenture. Wong Decl. ¶ 5.

2. Remittance of Income

Distribution of funds from the Joint Ventures to their foreign partners is regulated by Chinese law. Def. 56.1 ¶ 47; Jingtian Associates Opinion Re: Guarantee of Foreign Party's Investment Return ("Jingtian Op."), Ex. A to 11/2/99 Declaration of Zhao Yang ("Zhao Decl."), at 1.[10]

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Chinese policy. Pl. Reply at 2. Indeed, as discussed *infra* Part IV.A., plaintiff contends that defendant's impossibility arguments regarding a change in Chinese policy are based solely on hearsay and should be rejected on that basis alone. *Id.* at 2-3; Plaintiff's Memorandum of Law in Support of Its Motion for Summary Judgment ("Pl. Mem.") at 11-13.

10. Zhao Yang is defendant's legal counsel "in connection with the laws and regulations of the People's Republic of China." Zhao Decl. ¶ 1. Zhao issued the Jingtian Opinion on behalf of Jingtian Associates, a Beijing law firm. *Id.* ¶ 2.

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Under Chinese law, remittance of guaranteed income to foreign partners has "consistently" been under the "restriction, supervision and regulation" of the central Chinese Government, specifically China's State Administration of Foreign Exchange ("SAFE").[11] *Id.* In fact, pursuant to a notice issued by SAFE in April 1994, "the Chinese party in a [Chinese-foreign cooperative joint venture] shall not guarantee the foreign party's investment return rate, as it does in loans, bonds, or other forms. The said guarantee of investment return rate cannot be recognized or enforced by relevant Chinese authorities." *Id.*

Despite the central government's long-time prohibition against guaranteed income remitted by Chinese partners to foreign partners, local authorities regularly approved remittance of such income prior to 1998. The Jingtian Opinion explains that

> [a]lthough Chinese party's guarantee of foreign party's investment return rate in [a Chinese-foreign cooperative joint venture] is restricted by the State, such guarantee can possibly still be found in some places in China. Before September 1998, local foreign exchange authorities in some places in China allowed foreign investors in [Chinese-foreign cooperative joint ventures] to remit abroad their income obtained from the said guarantee abroad without obtaining special approval from SAFE.

Id. at 2.

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11. In contrast, remittance to foreign investors of after-tax profit or dividends may be made without prior approval of SAFE. Jingtian Op., Ex. A to Zhao Decl., at 2.

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In the wake of the 1997 Asian financial crisis, the Chinese Government realized that many foreign investment projects were depleting China's foreign exchange reserve rather than generating income for the State. *Id.* at 2-3; Wong Decl. ¶ 15. This situation was created, in part, by the practice of Chinese partners guaranteeing income to their foreign investment partners. Wong Decl. ¶ 15. To remedy the situation, the Chinese Government strengthened its supervision of foreign exchange and foreign debt. *Id.*; Jingtian Op. at 2-3. Of particular relevance to the instant litigation is a notice issued by SAFE on September 14, 1998 (the "SAFE Notice").[12] Among other things, the SAFE Notice requires "strict supervision of guarantees provided by domestic entities in connection with overseas financing activities of such entities." *See* 9/28/98 People's Daily Newspaper Article ("People's Daily Art."), Ex. A to Declaration of Patricia J. Wang, legal assistant to defendant's counsel Skadden, Arps, Slate, Meagher & Flom ("Wang Decl."), at 4.[13] Pursuant to the SAFE Notice,

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12. As discussed *infra* Part IV.A., the SAFE Notice is a confidential document of the Chinese Government that has not been publicly released. Zhao Decl. ¶ 3. As a result, neither defendant nor plaintiff have reviewed the document. *Id.* Defendant's descriptions of the terms and effects of the SAFE Notice are based on newspaper articles and discussions with Chinese authorities. Defendant's Memorandum of Law in Opposition to Plaintiff's Motion for Summary Judgment ("Def. Opp.") at 23-24.

13. The People's Daily news article was downloaded on September 18, 1999 from the Internet website address of Chinainfobank (www.Chinainfobank.com) by Haoling Liu, a legal assistant in the Beijing office of defendant's counsel Skadden Arps.

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> organizations must get . . . approval from [SAFE] and file with [SAFE] any required documentation if they need to provide guarantee to support the issuance of overseas debt. If the local government or entity violates [and] provide[s] the guarantee without prior approval, any loan or guarantee agreements shall be invalid, banks shall not open foreign exchange accounts for such guarantee, and the principal and the interest of such foreign debt shall not be permitted to be remitted abroad. . . .
>
> . . . [T]he entities that have incurred foreign debts will be examined in order to make sure that all foreign debts are properly serviced.

Id. According to defendant's legal counsel in China, the practical effects of the SAFE Notice are as follows:

> As a result [of the SAFE Notice], income obtained by foreign parties in [Chinese-foreign cooperative joint ventures] from the said guarantee can be remitted abroad only after obtaining special approval from SAFE, which may need a

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10/10/99 Declaration of Haoling Liu ("Haoling Decl.") ¶¶ 1-2. Chinainfobank is a Hong Kong company which provides Chinese Business and legal information to its users. *Id.* ¶ 2. According to Chinainfobank, the news article originally appeared in the September 18, 1998 edition of the People's Daily, the official newspaper of the Chinese Government. *Id.* The article, published in Chinese, was translated into English by Wang of Skadden Arps's New York office. Wang Decl. ¶ 2.

> comparatively long period of time. Consequently, if the [Joint Ventures are] engaged in such fixed return provided by the Chinese party, remittance of income [to Traffic Stream] from the said guarantee shall need special approval from SAFE.
>
> . . . Measures taken by the Chinese government in September 1998 to strengthen foreign exchange and foreign debt regulation shall have little material negative impact on [the Joint Ventures] with respect to the remittance of after-tax profit or dividend. However, since the examination has gotten more restrictive, the remittance of profit or dividend will need substantially more time.

Jingtian Op., Ex. A to Zhao Decl., at 3. In other words, the SAFE Notice has "little material negative impact" on the remittance of Operating Income to Traffic Stream. However, the remittance of Guaranteed Income to Traffic Stream requires prior approval from SAFE.

3. Effects of SAFE Notice on Traffic Stream

By October 1998, Traffic Stream, through its Hong Kong Subsidiaries, had received income remittances from the Joint Ventures sufficient to cover the November 1998 interest payment. Wong Decl. ¶ 11. On April 27, 1999, in anticipation of the May 3, 1999 interest payment, two Joint Ventures operating toll roads in the Shandong province applied to local authorities for remittance of Guaranteed Income to the Hong Kong Subsidiaries. *Id.* ¶ 14. The local authorities rejected

the Joint Ventures' request explaining that, pursuant to the September 1998 SAFE Notice, remittance of Guaranteed Income may only be authorized by SAFE.[14] *Id.* Defendant claims that prior to April 27, 1999, neither defendant nor its subsidiaries was aware of the SAFE Notice. *Id.* ¶ 11.

Upon learning of the policy change, the Joint Ventures together with the local Shandong authorities, contacted SAFE seeking immediate approval for the Joint Ventures' requested remittance of Guaranteed Income. *Id.* ¶ 18. SAFE refused, insisting that the Joint Ventures submit appropriate documentation to SAFE for approval of the toll-road projects. *Id.* According to defendant, SAFE "emphasized that only upon the granting of such reapproval would the Guaranteed Income be permitted to be remitted." *Id.* Although the Joint Ventures continued to lobby local authorities and SAFE for remittance prior to May 3, their efforts proved fruitless. *Id.* ¶¶ 19-20.

On May 16, 1999, the local Shandong authorities approved remittance to the Hong Kong Subsidiaries of the Operating Income for the Shandong Joint Ventures.[15]

14. According to defendant, even prior to issuance of the SAFE Notice, it took local authorities approximately two weeks to approve requests for foreign income remittance. Wong Decl. ¶ 8. As a result, even absent the SAFE Notice, it is unlikely that defendant would have received remittance of funds requested on April 27, 1999 by May 3, 1999.

15. Notably, approval for remittance of Operating Income was granted little more than two weeks after the Joint Ventures submitted their request on April 27. Thus, the SAFE Notice delayed approval for remittance of Operating Income by only a few days. *See supra* note 14; Wong Decl. ¶ 8.

Id. ¶ 20. However, the Operating Income generated by those Joint Ventures prior to May 1999 was insufficient to cover the required interest payment. *Id.* Since May, the Joint Ventures have persistently requested that local Shandong authorities submit the Shandong toll-road projects to SAFE for approval. *Id.* ¶¶ 21-24. To date, the appropriate documentation has not been submitted to SAFE.[16] *Id.* ¶ 24.

Traffic Stream claims that it "has done and continues doing all that is humanly possible within the framework of the Chinese administrative 'maze' to obtain approval for remittance of the Guaranteed Income." *Id.* ¶ 26. According to Traffic Stream, "[t]he regulatory and policy changes in [China] were completely beyond [defendant's] control and not within its reasonable anticipation." *Id.* ¶ 29.

III. Applicable Legal Standard

A motion for summary judgment may be granted only when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). "[G]enuineness runs to whether disputed factual issues can reasonably be resolved in favor of either party, [while] materiality runs to whether the dispute

16. The SAFE Notice primarily affects the two Shandong Joint Ventures because those Joint Ventures have consistently failed to generate Operating Income sufficient to fund their foreign partners' fixed annual return. Wong Decl. ¶ 16. As a result, the Chinese partners for those particular Joint Ventures must make up the shortfall through Guaranteed Income.

matters, i.e., whether it concerns facts that can affect the outcome under the applicable substantive law. A reasonably disputed, legally essential issue is both genuine and material and must be resolved at trial." *Mitchell v. Washingtonville Cent. Sch. Dist.*, 190 F.3d 1, 5 (2d Cir. 1999) (internal quotations and citations omitted).

In assessing the record to determine whether genuine issues of material fact are in dispute, courts must resolve all ambiguities and draw all reasonable factual inferences in favor of the non-moving party. *See Nora Beverages, Inc. v. Perrier Group of Am., Inc.*, 164 F.3d 736, 742 (2d Cir. 1998). The moving party bears the initial burden of demonstrating an absence of genuine issues of material fact. *See Schwapp v. Town of Avon*, 118 F.3d 106, 110 (2d Cir. 1997). However, if the moving party meets its initial burden, the non-moving party cannot rely upon conclusory allegations or speculation to create factual disputes. Instead, the non-moving party "must produce specific facts indicating that a genuine issue of fact exists. If the evidence [presented by the non-moving party] is merely colorable, or is not significantly probative, summary judgment may be granted." *Scotto v. Almenas*, 143 F.3d 105, 114 (2d Cir. 1998) (internal quotations and citations omitted) (alteration in original).

IV. Discussion

As set forth above, the sole issue to be resolved on summary judgment is whether defendant can plausibly maintain an impossibility defense based upon what it alleges is a change in Chinese policy regarding remittance of guaranteed income to foreign investors. Plaintiff contends that summary judgment is appropriate for three reasons.

First, plaintiff argues that evidence regarding the SAFE Notice cannot be used to defeat summary judgment because such evidence is inadmissible hearsay. *Second*, plaintiff claims that the express language of the Indenture precludes defendant from asserting an impossibility defense. *Third*, plaintiff contends that even assuming defendant's impossibility defense is not explicitly barred by the Indenture, defendant cannot make a legal showing of impossibility. Plaintiff's arguments are discussed in turn below.

A. Admissibility of Evidence Surrounding SAFE

Defendant's impossibility defense is premised on the SAFE Notice. As set forth above, however, the SAFE Notice is a confidential document of the Chinese government. *See supra* note 12; Zhao Decl. ¶ 3. Defendant does not possess — and cannot produce — a copy of the SAFE Notice. Zhao Decl. ¶ 3. Instead, defendant has provided Chase and this Court with a People's Daily newspaper article and an opinion by Chinese legal counsel describing "the [SAFE] Notice and its resulting consequences." Def. Opp. at 22.

Plaintiff contends that the People's Daily article is inadmissible hearsay because it is being proffered for the truth of its contents. *See* Pl. Reply at 7. Plaintiff argues that hearsay evidence that is not admissible at trial cannot be used to defeat a motion for summary judgment. *Id.* Plaintiff also complains that the Jingtian Opinion "is opaque at best as to what the SAFE Notice actually is intended to do." Pl. Mem. at 12. Stated succinctly, it is plaintiff's position that "[w]ithout providing the underlying [SAFE] Notice which is the foundation for its claim that a change in Chinese law

made performance impossible, Traffic Stream cannot escape" an adverse ruling. *Id.* at 11.

It is well-settled that inadmissible hearsay evidence cannot be used to create an issue of fact on summary judgment. *See McNamara v. Guanzzoni*, 99 Civ. 4058, 1999 WL 322648, *3 (S.D.N.Y. May 20, 1999). There is no question that the People's Daily article is hearsay; it is an out-of-court, unsworn statement being offered for the truth of its contents. *See* Fed. R. Evid. 801. However, that the article is hearsay does not necessarily mean it is inadmissible. There are numerous exceptions to the general rule barring hearsay evidence at trial.

Federal Rule of Evidence 807 sets forth a residual hearsay exception that is applicable to the instant case. Rule 807 provides:

> A statement not specifically covered by Rule 803 or 804 but having equivalent circumstantial guarantees of trustworthiness, is not excluded by the hearsay rule, if the court determines that (A) the statement is offered as evidence of a material fact; (B) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (C) the general purposes of these rules and the interests of justice will best be served by admission of the statement into evidence.

The People's Daily article is offered as evidence of a material fact, namely a change in Chinese policy which rendered

defendant's performance under the Indenture impossible. It is also the most probative evidence of the SAFE Notice that defendant can reasonably procure in light of the fact that the SAFE Notice has not been publicly released by the Chinese Government. Similarly, because the SAFE Notice is itself unavailable, the interests of justice would be best served by admission of the article. A large sum of money is at stake in this litigation, and defendant's sole defense is based on the SAFE Notice. To preclude the article would bar defendant from even trying to prove a defense of impossibility.

Finally, the People's Daily article has sufficient guarantees of trustworthiness. The People's Daily is published by the Chinese Communist Party's Central Commission, and it "is deemed to be authoritative and representing the official opinion of the Chinese Government." Haoling Decl. ¶ 2. In other words, there is little risk that a government controlled newspaper such as the People's Daily would inaccurately reflect the official position of its government. Accordingly, the People's Daily article may properly be considered on summary judgment, and defendant's impossibility defense is not precluded simply because the SAFE Notice is unavailable.[17]

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17. Rule 807 also includes the following notification requirement:

> [A] statement may not be admitted under this exception unless the proponent of it makes known to the adverse party sufficiently in advance of the trial or hearing to provide the adverse party with a fair opportunity to prepare to meet it, the proponent's intention to offer the

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Plaintiff further argues, with reasonable basis, that the Jingtian Opinion is "opaque". Both the newspaper article and the legal opinion are less than models of clarity. That said, the terms and effects of the SAFE Notice are set forth with sufficient clarity for plaintiff to rebut, and for the Court to evaluate, the merits of defendant's impossibility defense.

B. Impossibility of Performance

Defendant argues that its defaults should be excused pursuant to the doctrine of impossibility, because a change in Chinese policy — the issuance of the SAFE Notice — has delayed Traffic Stream's ability to collect monies from the toll-road projects, making it "impossible" for Traffic Stream to fulfill its payment obligations under the Indenture. *See* Def. Opp. at 11.

Impossibility is a common law contract doctrine which excuses performance under very limited and narrowly-defined circumstances. *See Kel Kim Corp. v. Central Markets,*

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> statement and the particulars of it, including the name and address of the declarant.

Fed. R. Evid. 807. On September 21, 1999, Traffic Stream provided Chase with an untranslated copy of the People's Daily article. *See* 9/21/99 letter from defendant's counsel Shmuel Vasser to plaintiff's counsel Sarah Reid, Ex. 6 to Reid Aff. On September 28, 1999, Traffic Stream provided Chase with a translated copy of the article. *See* 9/28/99 facsimile from Vasser to Reid, Ex. 7 to Reid Aff. Clearly, defendant has "made known" its intention to offer the People's Daily article sufficiently in advance of any potential hearing or trial in this matter.

Inc., 70 N.Y.2d 900, 902 (1987) (impossibility has been "applied narrowly, due in part to judicial recognition that the purpose of contract law is to allocate the risks that might affect performance and that performance should be excused only in extreme circumstances"). In *Kel Kim*, the New York Court of Appeals explained the impossibility defense as follows:

> Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must have been produced by an unanticipated event that could not have been foreseen or guarded against in the contract.

Id. Under New York law, where "the risk which causes the alleged impossibility of performance is foreseen, accounted for, and allocated in the contract, failure to perform cannot be excused." *Bank of Am. Nat'l Trust & Savs. Assoc. v. Envases Venezolanos, S.A.*, 740 F. Supp. 260, 267 (S.D.N.Y. 1990).

Plaintiff argues that defendant's impossibility defense must fail as a matter of law, both because it is precluded by the plain language of the Indenture and because defendant cannot make a showing of impossibility.

1. Impossibility Defense Barred by Indenture

Plaintiff contends that section 501 of the Indenture expressly bars defendant from asserting any impossibility

defense based upon a change in Chinese law. As set forth above, the preamble to section 501 states:

> "Event of Default", wherever used herein, means any one of the following events (whatever the reason for such Event of Default and whether it shall be voluntary or involuntary or be effected by operation of law or pursuant to any judgment, decree or order of any court *or any order, rule or regulation of any administrative or governmental body*) . . . .

Indenture, Ex. A to Reid Aff., § 501 (emphasis added); *see also supra* Part II.B. According to plaintiff, section 501 anticipates the possibility that government action might cause an event of default, and it assigns the risk of such government-induced default to defendant. *See* Pl. Mem. at 20.

The preamble of section 501 quoted above is identical to section 501 of the Model Debenture Indenture Provision. *See* Model Debenture Indenture Provision § 501 (1965). According to the American Bar Foundation Commentaries on the Model Debenture Indenture Provisions ("Model Indenture Commentaries"), "[t]he parenthetical clause in the first sentence of Section 501 has the purpose of refuting any argument that events resulting from *force majeure* were not intended to be treated as defaults." American Bar Foundation, Corporate Debt Financing Project, Commentaries on Model Debenture Indenture Provisions 205 (1971) (emphasis in original). Plaintiff cites the Model Indenture Commentaries as further support for its contention that section 501 assigns

the risk of adverse government action to defendant, and thus precludes defendant's impossibility defense. *See* Pl. Mem. at 20.[18]

a. Section 501 Interpreted as a Matter of Law

In a contract dispute, summary judgment may be granted where the relevant contract language is unambiguous and conveys a definite meaning. *See Sayers v. Rochester Tel. Corp. Supplemental Pension Plan*, 7 F.3d 1091, 1094 (2d Cir. 1993). Ambiguity is a question of law to be determined by the court. *See id.*; *Thomas De La Rue AG v. United States Banknote Corp.*, 979 F. Supp. 968, 971 (S.D.N.Y. 1997). Contract language is ambiguous where

> it is capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business.

Seiden Assocs., Inc. v. ANC Holdings, Inc., 959 F.2d 425, 428 (2d Cir. 1992) (internal quotations omitted). In contrast, contract language is unambiguous where it "has a definite and precise meaning, unattended by danger of misconception in the purport of the [contract] itself, and concerning which

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18. Section 501 is the only provision in the indenture that addresses force majeure events. The Indenture does not include a force majeure clause. Defendant's argument to the contrary is discussed *infra* Part IV.B.1.b.

there is no reasonable basis for a difference in opinion." *Id.* (alteration in original). Moreover, contract language "is not made ambiguous simply because the parties urge different interpretations. Nor does ambiguity exist where one party's view strain[s] the contract language beyond its reasonable and ordinary meaning." *Id.* (internal quotations omitted) (alteration in original).

Moreover, section 501 is a "boilerplate" indenture provision. *See Sharon Steel Corp. v. The Chase Manhattan Bank*, 691 F.2d 1039, 1048 (2d Cir. 1982) (defining "boilerplate" provisions as "contractual provisions which are standard in a certain genre of contracts" such as indentures); *see also* Model Debenture Indenture Provision § 501. The Second Circuit has long held that the meaning of "boilerplate" provisions should be determined by courts as a matter of law. *See id.*[19]

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19. In *Sharon Steel Corp.*, the Court of Appeals stated:

> Boilerplate provisions are . . . not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture. There are no adjudicative facts relating to the parties to the litigation for a jury to find and the meaning of boilerplate provisions is, therefore, a matter of law rather than fact.
>
> Moreover, uniformity in interpretation is important to the efficiency of capital markets. . . . [T]he creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital

(Cont'd)

b. Section 501

Under the plain language of section 501, the failure to tender a required payment constitutes an Event of Default, regardless of whether that failure was caused by a change in government policy. As plaintiff persuasively argues, the Indenture anticipates the risk of adverse government action, and it assigns that risk to defendant. *See* Pl. Mem. at 20; Model Indenture Commentaries 205. Accordingly, defendant's impossibility defense based on the SAFE Notice is precluded by the unambiguous terms of the Indenture.[20] *See Venezolanos*, 740 F. Supp. at 267 (barring defendant's impossibility defense where contract allocated risk that created the impossibility to defendant). Defendant's arguments to the contrary are inconsistent with the language of the Indenture, the Model Indenture Commentaries and general principles of contract law.

(Cont'd)

> markets. . . . Just such uncertainties would be created if interpretation of boilerplate provisions were submitted to juries sitting in every judicial district in the nation.

691 F.2d at 1048.

20. This Court makes no finding as to whether the Indenture precludes an impossibility defense based on a force majeure occurrence not explicitly set forth in the preamble to section 501. There is no need to reach this issue because it is undisputed that the SAFE Notice falls within the language of the preamble as an "order, rule or regulation of . . . a governmental body". Indenture, Ex. A to Reid Aff., § 501.

First, defendant draws a distinction between the issue of whether a default has occurred and the issue of whether a default is excused. *See* Def. Opp. at 15. According to defendant, section 501 determines only that a default has occurred; it does not address whether a particular default is excused pursuant to impossibility. *See id.* Thus, although defendant admits that its failure to make the required payments is an Event of Default under section 501, defendant claims that the language of section 501 regarding government action does not preclude its impossibility defense. Defendant's position is untenable.

In the instant case, defendant's distinction between an "occurrence of default" and an "excuse of default" is nothing more than a sleight-of-hand word game. Properly characterized, defendant is arguing that although Traffic Stream's failure to perform due to the SAFE Notice constitutes an "Event of Default", that default is excused because of the SAFE Notice. *See id.* at 15-16. This argument, however, renders the preamble clause of section 501 meaningless. If government action and other force majeure events can excuse a default under the Indenture, then section 501's clear instruction — that even if defaults are caused by force majeure events, they are to be treated as defaults — has no effect. *See* Model Indenture Commentaries 205 (section 501 "has the purpose of refuting any argument that events resulting from *force majeure* were not intended to be treated as defaults"). Defendant's reading of section 501 violates a basic tenet of contract law, namely that "[i]n construing a contract, one of a court's goals is to avoid an interpretation that would leave contractual clauses meaningless." *Two Guys from Harrison-N.Y., Inc. v. S.F.R. Realty Assocs.*, 482 N.Y.S.2d 465, 468 (1984).

Defendant's theory similarly ignores the undisputed fact that section 501 is a triggering provision for the comprehensive scheme of default remedies set forth in the contract. That is, once defendant's failure to perform is classified as an Event of Default under section 501, plaintiff may take advantage of all available remedies under the Indenture, including litigation. *See, e.g.*, Indenture, Ex. A to Reid Aff., §§ 502, 503. The interplay between section 501 and the remedy provisions further highlights defendant's strained interpretation of section 501. Under defendant's theory, even though Traffic Stream's failure to perform due to the SAFE Notice is an Event of Default such that plaintiff may commence litigation, the SAFE Notice may be used as a defense to that litigation. This is a flawed argument that cannot be reasonably supported by the plain language of the Indenture. As plaintiff explains: "It makes no sense whatsoever as a matter of contract construction for a default based upon a change in law or governmental act to be explicitly identified as an Event of Default so as to bring suit against the Issuer, if the defendant could then simply claim that this same change of law also excused its defaults for which it has been sued." Pl. Mem. at 8.

Second, defendant claims that section 514 of the Indenture is a general waiver provision "dealing with *force majeure* type defenses". Def. Opp. at 19 (emphasis in original). Defendant argues that because section 514 does not waive impossibility, impossibility is an available defense under the Indenture, regardless of the plain language of section 501. *See id.* Defendant's argument is puzzling to say the least, considering that section 514 is not a general waiver provision nor does it in any way address events of default or force majeure type defenses.

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Section 514, entitled "Waiver of Stay or Extension Laws", states:

> The Company covenants (to the extent that it may lawfully do so) that it will not at any time insist upon, or plead, or in any manner whatsoever claim or take the benefit or advantage of, any stay or extension law wherever enacted, now or at any time hereafter in force, which may affect the covenants or the performance of this Indenture; and the Company (to the extent that it may lawfully do so) hereby expressly waives all benefit or advantage of any such law and covenants that it will not hinder, delay or impede the execution of any power herein granted to the Trustee, but will suffer and permit the execution of every such power as though no such law had been enacted.

Indenture, Ex. A to Reid Aff., § 514. Stay or extension laws such as a stay of foreclosure or a stay of execution are procedural protections "designed for the relief of debtors, in times of general distress or financial trouble". *See* Black's Law Dictionary 983 (6th ed. 1990). Thus, section 514 is nothing more than an affirmative agreement by defendant to forgo the benefit of any applicable stay or extension laws. It is not a general waiver of contractual defenses.

Moreover, defendant's claim that section 514 is "the specific section dealing with *force majeure* type defenses", Def. Opp. at 19, is absurd. A force majeure clause "excus[es] nonperformance due to circumstances beyond the control of the parties." *Kel Kim*, 70 N.Y.2d at 903. Section 514 has

Appendix C

nothing to do with nonperformance, let alone nonperformance beyond the defendant's control.[21]

The bottom line is that defendant cannot escape the plain language of section 501 which demands performance regardless of whether such performance is rendered "impossible" by an uncontrollable act such as a change of law. Defendant is a sophisticated company involved in high-risk business ventures. Defendant could have included a force majeure provision in the indenture, but it failed to do so. Instead, defendant entered into an agreement that explicitly precludes force majeure events as a defense to full performance.

---

21. A comparison of section 514 and a classic force majeure clause further demonstrates the absurdity of defendant's argument. Set forth below is the force majeure provision at issue in *Kel Kim*:

> If either party to this [agreement] shall be delayed or prevented from the performance of any obligation through no fault of their own by reason of labor disputes, inability to procure materials, failure of utility service, restrictive governmental laws or regulations, riots, insurrection, war, adverse weather, Acts of God, or other similar causes beyond the control of such party, the performance of such obligation shall be excused for the period of the delay.

70 N.Y.2d at 902 n.*. Clearly, section 514 is not a force majeure clause nor does it address force majeure defenses. What is interesting, however, are the similarities between section 501 and the *Kel Kim* force majeure provision. Essentially, they are mirror images. The *Kel Kim* provision sets forth force majeure events that excuse performance, while section 501 sets forth force majeure events that do not excuse performance.

2. No Showing of "Impossibility"

Assuming arguendo that section 501 does not itself bar defendant's claim of impossibility, defendant's claim must still fail because defendant cannot, as a matter of law, meet the requirements of an impossibility defense. I note at the outset, that parties attempting to invoke impossibility of performance have an uphill battle. New York courts have been consistently hostile to the defense, allowing it to excuse performance only in the most extreme circumstances.

a. Objectively Impossible

As set forth above, the first element of an impossibility defense is a showing by defendant that performance has been rendered objectively impossible: "Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible." *Kel Kim*, 70 N.Y.2d at 902; *see also 407 East 61st Garage, Inc. v. Savoy Fifth Avenue Corp.*, 23 N.Y.2d 275, 281 (1968) ("[I]mpossibility of performance is limited to the destruction of the means of performance by an act of God, vis major, or by law.").

Of particular relevance to this case is the well-settled rule in New York that " 'where impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused.' " *Venezolanos*, 740 F. Supp. at 267 (quoting *407 East 61st Garage*, 23 N.Y.2d at 281); *see also Barclays Bus. Credit, Inc. v. Inter Urban Broad. of Cincinnati, Inc.*, 90 Civ. 2272,

1991 WL 258751, *8 (S.D.N.Y. 1991) (finding that "New York law is absolutely clear" regarding rule that impossibility cannot be premised on financial hardship, no matter how severe). Moreover, even where the financial hardship is caused by a government policy, performance cannot be excused as "impossible": "[A]bsent an express contingency clause in the agreement allowing a party to escape performance under certain specified circumstances, compliance is required even where the economic distress is attributable to the imposition of governmental rules and regulations or the inability to secure financing." *Stasyszyn v. Sutton E. Assocs.*, 555 N.Y.S.2d 297, 299 (1st Dep't 1990).

Defendant's allegations of impossibility fall squarely within this line of "financial hardship" cases. According to defendant,

> [i]t is undisputed that as a result of the regulatory changes in China, Traffic Stream's only source of income — the remittance of guaranteed payments by Chinese joint venture partners — has dried up. Thus, the regulatory change, which indisputably has delayed the ability to collect guaranteed payments out of China, has made it impossible for Traffic Stream to make the required payments within the time frames set forth in the Indenture.

Def. Opp. at 11. Stripping away the conclusory language, Traffic Stream merely alleges that the SAFE Notice has "delayed" its ability to collect payments from the Joint Ventures, leaving Traffic Stream without enough money to meet its financial obligations. However, lack of funds, "even

to the extent of insolvency or bankruptcy", can never excuse contractual performance. *Venezolanos*, 740 F. Supp. at 267 (internal quotations omitted).[22]

Defendant concedes, as it must, that the SAFE Notice merely "delays" rather than prohibits the remittance of funds from the Joint Ventures to Traffic Stream. According to defendant's Chinese legal counsel, the SAFE Notice has "little material negative impact" on the remittance of Operating Income to Traffic Stream. *See* Jingtian Op., Ex. A to Zhao Decl., at 3. Indeed, on May 16, 1999, local Shandong authorities approved remittance to the Hong Kong Subsidiaries of the Operating Income for the Shandong Joint Ventures. *See* Wong Decl. ¶ 20. The SAFE Notice delayed that approval by only a few days. *See id.* ¶ 8. Similarly, the SAFE Notice does not preclude the remittance of Guaranteed Income. Rather, it requires that such remittance be approved by SAFE. *See* Jingtian Op., Ex. A to Reid Aff., at 3.

Of course, as set forth above, the practical effects of the SAFE Notice are legally irrelevant to defendant's impossibility defense. To use plaintiff's words: "The SAFE Notice is not a law or regulation that prohibits, delays or

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22. From a common sense perspective, mere financial hardship can never support a claim of "objective" impossibility because it is caused by "subjective" factors unique to the financially distressed entity. In other words, although Traffic Stream itself did not have enough money to make payments under the Indenture, dozens of other companies with adequate financial resources could have easily made the required payments. Financial hardship means that the distressed individual is unable to make payments under a contract. It does not mean that the contract is incapable of being performed.

affects the legal ability of Traffic Stream, a British Virgin Islands corporation, from making the required payments, and therefore cannot excuse its failure to perform." Pl. Reply at 4. Put simply, Traffic Stream borrowed $119,000,000 from the United States markets based on its unconditional promise to pay. That Traffic Stream now claims it has no money, whatever the reason, cannot as a legal matter support a claim for objective impossibility. *See Stasyszyn*, 555 N.Y.S.2d at 299. Indeed, to excuse Traffic Stream's performance under these circumstances would open the floodgates and undermine our system of financial contracting.[23]

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23. Defendant cites a number of cases to support its claim that the SAFE Notice renders Traffic Stream's performance under the Indenture impossible. However, all of the cases defendant cites are distinguishable from the instant case in that they involve government or judicial action that either directly restricted performance under a contract or substantially altered the terms of the contract. For example, in *Studio 54 Disco, Inc. v. Pee Dee Jay Amusement Corp.*, 439 N.Y.S.2d 395 (2d Dep't 1981), the court denied plaintiff's motion for summary judgment where defendant was unable to complete a required sale of property due to a judicial order explicitly restricting the sale of the property. In that case, neither defendant nor anyone else could perform under the contract due to the court order. Thus, performance was "objectively impossible."

In *Moyer v. City of Little Falls*, 510 N.Y.S.2d 813 (Sup. Ct. Herkimer Co. 1986), plaintiff entered into a five-year sanitation contract with the defendant city. The contract price was based on plaintiff's ability to dump refuse at a local landfill for $1.50/cubic yard. *See id.* at 814. Less than a year later, the state closed the local landfill creating a landfill monopoly. *See id.* The monopolist increased the dumping price by 666% within a one-year time period. *See id.* at 815. Because the terms of the contract were fundamentally altered,

(Cont'd)

b. Foreseeability

To succeed on an impossibility defense, not only must performance be objectively impossible, but "the impossibility must have been produced by an unanticipated event that could not have been foreseen or guarded against in the contract." *Kel Kim*, 70 N.Y.2d at 902. Because defendant cannot make a showing of objective impossibility, the Court need not reach this second prong. However, for the sake of thoroughness, I briefly address the issue.

Traffic Stream argues that it "did not foresee" the actions of the Chinese Government, nor could it "have reasonably contemplated them." Def. Opp. at 9. In support of its argument, Traffic Stream has submitted a declaration from Traffic Stream's Executive Director, Mr. Wong. In his declaration Mr. Wong states:

> The [Chinese] government has, during the recent years given high priority to the development of transportation infrastructure. . . . It is envisaged that more and more toll road projects in [China] will be funded by international financial institutions, foreign government loans, and various other sources of the global capital market.

(Cont'd)
the court held that plaintiff's performance was excused under the doctrine of impossibility. *See id.* Unlike the contract in *Moyer*, the terms of the Indenture have not changed. They are exactly the same now as they were when defendant entered into the agreement on May 6, 1998.

> Against this platform, [Traffic Stream] has never expected that the [Chinese] government would stage any new policies or regulations to the contrary, nor could it.
>
> The regulatory and policy changes in [China] were completely beyond [Traffic Stream's] control and were not within its reasonable anticipation.

Wong Decl. ¶¶ 27-29. Mr. Wong has also attached several newspaper articles discussing China's commitment to development of a transportation infrastructure through foreign investment. *See id.* at Ex. D.

As set forth *supra* Part IV.B.1.b., section 501 anticipates the possibility that government action might cause an event of default, and it assigns the risk of such government-induced default to defendant. Thus, pursuant to section 501, not only was the Chinese government's action foreseeable, it was foreseen and expressly provided for in the contract.

However, assuming arguendo that section 501 does not address adverse government action, the issue of whether the SAFE Notice could have been foreseen and guarded against is a question of fact. Although just barely, Mr. Wong's declaration and attachments raise an issue of fact that cannot be resolved on summary judgment.

That said, I find it highly implausible that sophisticated companies involved in foreign business ventures in China — business ventures that are intertwined with the State and local governments — "could not have foreseen the

possibility" that the Chinese Government might pass unfavorable foreign exchange or foreign investment regulations. Business ventures involving foreign governments and foreign corporations are always fraught with risk. However, business ventures in a communist state that is just warming to the foreign capital markets seems a particularly risky undertaking.

Moreover, despite China's announced commitment to foreign investment, there were signs of trouble well in advance of the parties' execution of the Indenture. Defendant's own expert references the 1997 Asian financial crisis stating: "I believe that the adoption of the [SAFE] Notice by the [Chinese Government] is in response to the 1997 Asian financial crisis and to strengthen the control on foreign exchange." Zhao Decl. ¶ 4.

* * * *

For the reasons set forth above, I find that defendant's impossibility defense is precluded by the plain language of section 501 of the Indenture. Moreover, I find that even absent the provisions of section 501, defendant has not made a sufficient legal showing of impossibility. Accordingly, plaintiff's motion for summary judgment is granted with respect to its claims for breach of contract and replevin of collateral (claims one and two).

V. Additional Claims

As set forth above, plaintiff also seeks summary judgment with respect to its claims for specific performance, an accounting and reasonable attorneys' fees.

A. Reporting Obligations

Plaintiff seeks specific performance of defendant's reporting obligations under section 1009 of the Indenture. As set forth above, the Indenture authorizes Chase to bring suit for "specific performance of any covenant or agreement in the Indenture." Indenture, Ex. A Reid Aff., § 503.

In its opposition, defendant concedes that it is "bound by its contractual obligations to provide Chase with the reports required by the Indenture." Def. Opp. at 25. Accordingly, plaintiff's motion for summary judgment is granted with respect to its claim for specific performance (claim three), and defendant is hereby directed to provide Chase with the required financial reports.

B. Accounting

In claim four of the complaint, plaintiff seeks an accounting. However, because plaintiff is entitled to specific performance of defendant's financial reporting obligations under section 1009 of the Indenture, including audited financial statements, *see supra* Part V.A; Indenture, Ex. A to Reid Aff., § 1009, plaintiff's additional request for an accounting is moot.

C. Collection Costs

Plaintiff seeks collection costs in the form of reasonable attorneys' fees pursuant to section 503 of the Indenture. *See* Pl. Mem. at 24. Section 503 requires defendant to pay the Trustee "such further amount as shall be sufficient to cover the costs and expenses of collection, *including*

the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel." Indenture, Ex. A to Reid Aff., § 503 (emphasis added).

Under New York law, "[r]easonable attorneys' fees are properly awarded when authorized by agreement." *Granada Condominium I v. Morris*, 639 N.Y.S.2d 91, 93 (2d Dep't 1996). Moreover, defendant does not oppose plaintiff's request for attorneys' fees. Therefore, plaintiff is entitled to reasonable attorneys' fees and should submit its request for such fees no later than February 18, 2000.

VI. Conclusion

For the foregoing reasons, plaintiff's motion for summary judgment is granted in its entirety.[24] Plaintiff is directed to foreclose on the Collateral Accounts and to submit a request for a deficiency judgment by February 18, 2000.

Defendant must provide the required financial reports to plaintiff by February 18, 2000. Once the Court sets reasonable attorneys' fees, the parties are directed to prepare a final judgment.

SO ORDERED:

s/ Shira A. Scheindlin
Shira A. Scheindlin
U.S.D.J.

Dated: New York, New York
January 31, 2000

24. Plaintiff's motion is granted in its entirety with the exception that plaintiff's request for an accounting is denied as moot. *See supra* Part V.B.

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING DATED AND FILED JULY 24, 2001

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

ROSEANN B. MACKECHNIE
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 24th day of July two thousand one.

00-7721

THE CHASE MANHATTAN BANK, as Indenture Trustee, under the Indenture, dated as of May 6, 1998,

Plaintiff – Appellee,

v.

TRAFFIC STREAM (BVI) INFRASTRUCTURE LIMITED,

Defendant – Appellant.

Appendix D

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellee The Chase Manhattan Bank.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED.**

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has been requested that a vote be taken thereon.

FOR THE COURT

ROSEANN B. MACKECHNIE,
Clerk

By: s/ Beth J. Meador
Beth J. Meador
Administrative Attorney